INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE-MIS No.: TAM-121139-16

Director, Employee Plans Examinations

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Year(s) Involved:
Date of Conference:

LEGEND:

Taxpayer:

Entity 1:

Entity 2:

Entity 3:

Entity 4:

Entity 5:

Plan A:

Plan B:

ISSUE:

Are the annual additions credited to the account of the Taxpayer in Plan A and the annual additions credited to the account of the Taxpayer in Plan B required to be aggregated for purposes of § 415(c)(1) of the Internal Revenue Code, due to the application of the controlled group rules under § 414(c)?

CONCLUSION:

The annual additions credited to the accounts of the Taxpayer in Plan A and Plan B are required to be aggregated for purposes of § 415(c)(1), due to the application of the controlled group rules under § 414(c).

FACTS:

The Taxpayer is the sole owner and employee of Entity 1 and Entity 2. Entity 1 and Entity 2 are in a § 414(c) brother-sister controlled group. Entity 2 is also a partner in Entity 3, along with other partners. All of the partners are professional corporations, except for two individual doctors. Each partner holds a % interest in Entity 3. The Taxpayer is also a partner as an individual in a related organization, Entity 4, with the same other partners, as individuals.

Entity 3 is a group providing medical imaging services. The Taxpayer also services patients at a hospital and receives separate self-employment income through Entity 1. Entity 2, Entity 3, Entity 4, and the other professional corporations that are partners in Entity 3, constitute an affiliated service group, Entity 5, under § 414(m)(2)(A).

Both Entity 3 and Entity 4 have staff employees. In 2012, Entity 3 had approximately 12 employees and Entity 4 had approximately employees. The other professional corporations that are partners in Entity 3 are identical in structure to Entity 2. Each such professional corporation is also owned 100% by a doctor who is the sole employee of his or her professional corporation.

Entity 1 maintains Plan A, in which the Taxpayer is the sole participant. Entity 3 sponsors Plan B, a volume submitter profit-sharing plan with a cash or deferred arrangement. Entity 2 is one of the participating employers in Plan B. The Taxpayer is participating in Plan B as the sole employee of Entity 2.

Pursuant to § of Plan B, the term “Employer” means Entity 3 and any participating employer, including Entity 2. Section of Plan B provides that unless the context of the plan clearly indicates otherwise, the word “Employer” shall be deemed to include each participating employer as related to its adoption of the plan. Section of Plan B provides that contributions made by participating employers may be commingled into one trust fund, but any contributions shall be held for the exclusive benefit of the employees of each participating employer, and the trustee must keep separate books and records regarding each employer. Participating employers also pay their proportional share of expenses of the trust.

The majority of partners of Entity 3 participate in Plan B through their professional corporations. The employees of the partners of Entity 3 make pre-tax contributions to Plan B from the pay received through their professional corporations, and the professional corporations make matching and profit-sharing contributions on their employees' behalf. The staff employees of Entity 3 and Entity 4 also participate in Plan B. Entity 3 and Entity 4 make employer contributions on behalf of their own employees.

The Taxpayer contributed $ to Plan A in 2012. The Taxpayer also made elective contributions to Plan B of $ ($ in elective deferrals and $ in catch-up contributions) in 2012. In addition, Entity 2 made $ in matching contributions and $ in profit sharing contributions to Plan B on the Taxpayer's behalf. Thus, in 2012, the Taxpayer contributed a total of $ to Plan A and Plan B. The § 415(c) limit was $50,000, excluding catch-up contributions. Entity 2 filed a Form 1120, U.S. Corporation Income Tax Return, reporting deductions for plan contributions and other deductions.

Entity 2 received a Schedule K-1 (Form 1065) Partner's Share of Income, Deductions, and Credits, etc., from Entity 3 for its distributive share of Entity 3's income for 2012 in the amount of $. Entity 2 reported this amount in income on its Form 1120. Entity 2 deducted compensation of officers, taxes and licenses, interest, depreciation, pension and profit-sharing plan contributions, employee benefits costs and other items. After taking deductions, Entity 2 had a 2012 net income of zero. The Taxpayer received a gross salary from Entity 2 of $.

LAW AND ANALYSIS:

Section 414(c) generally provides that all employees of trades or businesses (whether or not incorporated) which are under common control shall be treated as employed by a single employer for purposes of §§ 401, 408(k), 408(p), 410, 411, 415 and 416.

Section 1.414(c)-2 of the Income Tax Regulations provides that two or more trades or businesses under common control includes a brother-sister controlled group. A brother-sister controlled group is two or more organizations conducting trades or businesses if (i) the same five or fewer persons own a controlling interest in each organization (at least 80%) and (ii) taking into account these interests only to the extent they are identical, have effective control (more than 50%).

Congress enacted § 414(m) in 1980 to aggregate certain entities that did not have sufficient common ownership to form a controlled group. Section 414(m) provides that all members of an affiliated service group must be aggregated for purposes of the employee benefit requirements under §§ 401(a)(3), (4), (7), (16), (17),and (26), and §§ 408(k), 408(p), 410, 411, 415 and 416. Under § 414(m)(2), an affiliated service group is a group consisting of a First Service Organization (FSO) whose principal business is providing services, and at least one other related organization. A related organization can be either an “A” organization – a service organization that is a shareholder or partner in the FSO and regularly performs services for it or is regularly associated with it in performing services for others, or a B organization – any other organization a significant portion of whose business is performing services for the FSO, the A organization, or both, if those services are of the type historically performed by employees, and if at least 10% of its interests is held by highly compensated employees of the FSO or an A-organization.

Proposed regulations were issued in 1983 under § 414(m)(2). Section 1.414(m)-1(a) of the proposed regulations provides:

(a) In general. Section 414(m) provides rules that require, in some circumstances, employees of separate organizations to be treated as if they were employed by a single employer for purposes of certain employee benefit requirements. For other rules requiring aggregation of employees of different organizations, see section 414(b) (relating to controlled group of corporations) and section 414(c) (relating to trades or business under common control). If aggregation is required under either of the preceding provisions and also under section 414(m), the requirements with respect to all of the applicable provisions must be satisfied.

Section 415(c) provides in part that contributions and other additions with respect to a participant exceed the limitations under that section when such annual additions are greater than the lesser of a stated dollar amount ($50,000 in 2012) or 100% of the participant’s compensation.

Section 1.415(a)-1(f)(1) provides that all employees of controlled groups under §§ 414(b) or (c) are treated as employed by a single employer so that a plan maintained by any member is deemed maintained by all of the members. Section 1.415(a)-1(f)(2) states that any plan maintained by a member of an affiliated service group is deemed maintained by all members of that affiliated service group.

Entity 1 and Entity 2 are in a controlled group and are treated as a single employer under § 414(c). The application of § 414(c) requires that Plan A and Plan B contributions be combined under one § 415(c) limit. When the contributions are combined, the Taxpayer has exceeded the limit by $ for 2012. The result does not change simply because Entity 2 is also in an affiliated service group under § 414(m) as part of Entity 5. Although another provision of the Code, § 414(r), allows disaggregation for certain purposes when an employer is operating separate lines of business for bona fide business reasons, § 414(r) is inapplicable in this case. No other statutory provisions would allow trades or businesses under common control under § 414(c) to be disaggregated.

The conclusion that both sets of rules must be met separately and in their entirety is consistent with §1.414(m)-(1)(a) of the proposed regulations. As noted above, that proposed regulation provides that if aggregation is required under either § 414(b) or § 414(c) and also under § 414(m), the requirements with respect to all of the applicable provisions must be satisfied. Thus, the proposed regulations are consistent with, and support the conclusion that, Entity 2, as a member of both groups, must take into account its relationship with each group to separately satisfy all of the requirements of § 414(c), as well as all of the requirements of § 414(m).

In addition, legislative history supports the position that the application of the § 414(c) provisions cannot be avoided by application of the provisions under § 414(m). Legislative history related to amendments made by the Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647) to § 414(m) suggests that the controlled group rules should be considered first, stating that an affiliated service group may not be treated as consisting of separate lines of business or operating units under § 414(r), and that "…because generally section 414(b) and (c) applies before section 414(m), a group that is treated as aggregated under section 414(b) and (c) is not treated as an affiliated service group even if such group could also have been aggregated under section 414(m)." [1]

If both sets of rules must be separately met, and, further, the controlled group rules apply before the affiliated service group rules, the applicable tax qualification requirements must first be separately met by the controlled group (which consists of Entity 1 and Entity 2). The result is that the contributions to Plan B, in which Entity 2 is a participating employer, would be combined with the contributions to Plan A for § 415(c) purposes.

The Taxpayer argues that Entity 1 and Entity 2 are not in a controlled group for purposes of determining the § 415(c) limits for Plan A and Plan B. According to the Taxpayer, because Entity 2 is a part of Entity 5 (an affiliated service group under § 414(m)), Entity 2 is not the employer maintaining Plan B on behalf of the Taxpayer for purposes of § 415(c), but rather, based on § 414(m)(1), Entity 5 is treated as the single employer maintaining Plan B. The Taxpayer then argues that if Entity 5 is treated as the single employer maintaining Plan B, Entity 1 does not have a sufficient relationship with Entity 5 to be treated as a single employer in a controlled group with Entity 5 under

[1] H.R. Rep. No. 795, 100th Cong., 2d Sess. (1988)

§ 414(c) for § 415 purposes (and accordingly the Taxpayer may have a separate § 415 limit apply for purposes of participating in any plans sponsored by Entity 1 from the § 415 limit that would apply for purposes of participation in any plans sponsored by Entity 5).

However, the Code and legislative history indicate that the aggregation of §§ 414(c) and 414(m) must be separately met in their entirety, which is also consistent with §1.414(m)-(1)(a) of the proposed regulations. While, pursuant to § 414(m)(1), all the employers in Entity 5 (including Entity 2) are treated as a single employer for § 415(c), in addition, pursuant to § 414(c), Entity 1 and Entity 2 are treated as a single employer for purposes of § 415(c). It is with respect to the controlled group under § 414(c) between Entity 1 and Entity 2 that the Taxpayer exceeded the limitations under § 415(c).[2]

The Taxpayer also argues that he could have had two separate § 415(c) limits if he owned the partnership interests of Entity 3 as an individual, rather than through Entity 2. The Taxpayer argues that the IRS is elevating form over substance to come to a different result just because Entity 2 is the partner in Entity 3, rather than the Taxpayer. However, Entity 2 is an entity in its own right. Entity 2 is described as a "participating employer" along with the other professional corporations and is also defined as an "employer" under the terms of Plan B. Entity 2 performs functions that an employer would perform, such as making matching contributions to the § 401(k) plan and profit-sharing contributions, taking deductions under § 404 for employer contributions, and filing its own Form 1120. The Taxpayer chose to have Entity 2 participate as a partner in Entity 3, not the Taxpayer, and to treat Entity 2 as the employer of the Taxpayer.

We conclude that the controlled group rules under § 414(c) require that Entity 1 and Entity 2 be treated as a single employer for purposes of § 414(c), and that the conclusion that Entity 1 and Entity 2 are a single employer with respect to the Taxpayer is not affected by any application of § 414(m). As a result, the annual additions credited to the accounts of the Taxpayer in Plan A and Plan B are required to be aggregated for purposes of § 415(c)(1).

CAVEAT:

A copy of this technical advice memorandum is to be given to the taxpayer.
Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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[2] Because this conclusion is not affected by any application of § 414(m), this technical advice memorandum does not address any other possible implications resulting from Entity 2's overlapping membership in both the § 414(m) affiliated service group and the § 414(c) controlled group.