LDSCO
LOREN D. STARK COMPANY

Surgical Centers and the Affiliated Service Groups (ASG's) Rules

All of the employees of the members of an ASG are treated as employees of the same employer [IRC Sec. 414(m)(1)] for purposes of minimum participation requirement [IRC Sec. 410(b)], nondiscriminatory benefits [IRC Sec. 401(a)(4)], minimum vesting requirement (IRC Sec. 411), maximum benefits (IRC Sec. 415), maximum compensation for plan purposes [IRC Sec. 401(a)(17)], and the Defined Benefit coverage requirement of 40% of the nonexcludable employees [IRC Sec. 401(a)26]. An ASG means a group consisting of a service organization referred to as the First Service Organization (FSO) and one or more of the following service organizations:
An organization which is a shareholder or partner of the FSO and regularly performs services for the FSO and/or is regularly associated with the FSO in performing services for third persons [IRC Sec. 414(m)(2)(A)] referred to as an "A Org." and/or
Any other organization if a significant portion of the business of such organization, generally referred to as a "B Org.," is the performance of services for a FSO or an A Org. of the type historically performed by employees in such service business and 10% or more of such B Org. is held by Highly Compensated Employees (HC's) [IRC Sec. 414(q)] of the FSO or A Org. [IRC Sec. 414(m)(2)(B)].

Also, under IRC Sec. 414(m)(5), any organization performing management functions on a regular and continuing basis for another organization or its related organizations create a management ASG even though there is no common ownership of the management organization and the organization or related organizations receiving the management services. For this purpose, organizations are related if more than 50% of which is directly or indirectly owned [attribution under IRC Sec. 318(a) applies] by such other organization and is considered a member of the ASG in combination with the related organization for which management functions are performed. The controlled group rules of IRC Sec. 1563 are used except that more than 50% is substituted for the "at least 80 percent" rule. The proposed IRS regulations under IRC Sec. 414(m)(5) were withdrawn and, therefore, taxpayers have no guidance as to the precise application of this type of ASG. However, it would seem that a substantial portion of the managing organization's functions would need to be "management" under the definition in IRC Sec. 414(m)(5)(A) stipulating that the "principal business" is performing management functions "on a regular and continuing basis." Therefore, unless the predominant business function is management, an ASG analysis need only focus on the "service" organization's application of the rules.
In 1983, the IRS issued proposed regulations as to the "Service" organization ASG. These regulations [IRC Reg. Sec. 1.414(m)] have never become final but are the only guidance the taxpayer has been given but, pending the adoption of final regulations, the taxpayer may rely on these proposed regulations. There must be an FSO before there is required aggregation of employers for the application of qualified plan rules under the ASG rules. The Internal Revenue Code (the Code) has given the IRS the authority by regulation to defined an ASG. Based on this authority, the IRS stipulated that only professional service corporations legally authorized to be performed by the following professional services would be treated as an FSO with an A Org.:

Certified Public Accountants
Actuaries
Architects
Attorneys
Chiropodists
Chiropractors
Medical Doctors

Dentists
Professional Engineers
Optometrists
Osteopaths
Podiatrists
Psychologists
Veterinarians

With the change in the Code causing plans established by all business forms to be on parity with the corporate sponsored plans, the regulation should possibly be read to mean all forms of such professional organizations, although there is no authority for this expansion of the rules at this time. If there is no FSO, there is no ASG. However, for purposes of an ASG with an FSO and a B Org., the regulations provide that the FSO can be any service organization which is defined as any business for which capital is not a material income-producing factor. Specifically, in paragraph 1.414(m)-2(f)(1) of the regulation, it mentions that capital is not a material income-producing factor if gross income consists principally of fees, commissions or other compensation for personal services performed by an individual. Therefore, real estate agent can be an FSO with a B Org. resulting in required aggregation. Further, however, the proposed regulation [1.414(m)-2(f)(2)] provides that any organization engaged in the following fields without regard to capital requirements is a service organization for purposes of the formation of an ASG with a B Org.:

Health
Law
Engineering
Architecture
Accounting
Actuarial Science
Performing Arts
Consulting
Insurance

The proposed regulations exempt manufacture and sale of equipment and supplies, and research in these services from the status of "service organization."
Facts and Circumstances
Assuming medical doctor D owns less than 10% of surgical center C and receives a share of C's income relative to his referrals to C and his ownership. C collects fees for D from patients referred to C for procedures performed by D at C's facilities and remits to D for a fee. During the procedure, C's employees assist D, charging the patient for such services. D's gross receipts from C are less than 10% of C's total gross receipts. D has no employees other than as a result of an ASG formed by C and another FSO. The employees of such an ASG would not be aggregated with the employees of the potential ASG of D and C [1.414(m)-2(g)]. C has 60 employees, all nonhighly compensated (NHC).

Question
Do the facts and circumstances set forth above create an ASG with D and C in any of the following combinations:
Management Organization – A management organization has not been formed in that no management functions are performed.
B Organization – Neither C or D can be considered a B Org. in that the ownership of C by D is less than 10% and C owns no part of D.
FSO and A Org.

a. C cannot be an A Org. and D an FSO in that C owns no part of D.

b. D may be an A Org. and C an FSO in that D owns some part of C if D is "regularly associated" with D in performing services (medical in this case) for third persons (i.e., patients). The key phrase is "regularly associated" which the proposed regulation defines as facts and circumstances such as the "amount" of earned income D derives from the association with C [1.414(m)-3(b)(2)].

Analysis

If D is an A Org. and C the FSO, D's Qualified Plan would be required to be aggregated with C's plan in order to satisfy coverage, etc. All doctors in D's position would also form separate ASG's with C with the same issues. This result would be untenable.
Since highly compensated employees (HC's) may be excluded and all doctors would be HC's as a result of ownership of their respective medical practices, C's plan has no jeopardy from aggregation with multiple ASG's. The significant question then is “can D be an A Org and C the FSO?”. Inasmuch as the proposed regulation provides no guidance as to the meaning of "regularly associated" (i.e., there is no safe harbor), the taxpayer must speculate. It would appear that an ASG was not contemplated by the IRS under these facts and circumstances for the following reasons:
The "amount" of earned income contemplated by the IRS to establish the regularly associated relationship certainly must be greater than the safe harbor of 10% of gross income provided in the B Org. determination of the proposed regulation. Therefore, if D's receipts from C are less than 10% of his gross income, D would not be "regularly associated" with C. C is not an FSO because it is not organized to provide medical services. Its purpose clause stipulates that it is organized to provide facilities and support staff to D to assist D in the performance of his medical practice. Also, under the general rule [1.414(m)-2f(2)], an organization will not be considered a "service organization," and, therefore, not a potential FSO "merely because an employee provides one of the enumerated services, Health services in our case, to the organization (i.e., service to C or D) for the benefit of the patient. The service provided to D by C for the benefit of his patients cannot create a B Org. in that D owns less than 10% of C.

Solution
In the event the parties to a situation which may be a potential ASG in a situation similar to our facts are not comfortable with a "Probably not" answer to the question as to the ASG issue, an IRS determination letter request should be submitted so as to settle the question.