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AFFILIATED MANAGEMENT GROUP AND
CODE § 414(M)

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THE
AFFILIATED MANAGEMENT GROUP AND
CODE § 414(m)

by Robert M. Reed, J.D., C.P.A.

I. DEFINITIONS

A. Affiliated Service Group.

An Affiliated Service Group means a group consisting of a management organization and a recipient organization.

B. Organization.

Organization means a sole proprietorship, partnership, corporation, trust, association, company, estate or any other type of entity, regardless of its ownership format.

C. Management Organization.

Management Organization means:

1. An organization; and
2. All organizations aggregated with such organization, the principal business of which is to perform on a regular and continuing basis management functions for a recipient organization.

D. Recipient Organization.

Recipient Organization means:

1. An organization for which management functions are performed;
2. All organizations aggregated with such organization; and

3. All organizations related to such organization.

E. Aggregated Organizations.

Organizations are aggregated with a recipient organization in accordance with:

1. Code § 414(b)-Controlled Groups;
2. Code § 414(c)-Controlled Groups;
3. Code § 414(m)-Affiliated Service Groups; and
4. Code § 414(o)-as otherwise set forth in the regulations.

F. Related Organizations.

An organization is related to a recipient organization if the first organization and the recipient organization would be related persons pursuant to Code § 144(a)(3) and the management organization performs management functions for the first organization.

G. Employee.

Employee includes a self-employed individual as defined in Code § 401(c)(1).

H. Services Performed.

Services performed for a person other than as an employee of such person means services performed directly or indirectly for such person.

II. DETERMINATION OF PRINCIPAL BUSINESS ON A REGULAR AND CONTINUING BASIS.

A. Two-Tax Year Rolling Percentage.

1. A management organization exists with respect to a particular recipient organization for a tax year of the management organization during which the performance of management functions and other services for the recipient organization constitutes more than 50% of the management organization's business activities during the two-tax year period that includes such tax year and the prior tax year.
2. If the management organization was not in existence prior to the current tax year, the more than 50% test shall apply only to the current tax year.
3. Once the more than 50% test is met, the management organization will continue to be a management organization with respect to a particular recipient organization for each subsequent tax year during which the performance of management functions and other services for such recipient organization constitutes more than 40% of the management organization's business activities during the two-tax year period that includes such subse-

quent tax year and the immediately preceding tax year unless:

- (a) the performance of management functions and other services for the recipient organization constitutes less than 5% of the management organization's business activities during such subsequent tax year;
- (b) there is an intervening tax year for which the management organization and the recipient organization do not satisfy the more than 40% test; or
- (c) the management organization satisfies the more than 50% test with respect to a different recipient organization for such subsequent tax year and the immediately preceding tax year.

4. If one or more of the three exceptions described above applies to a management organization and a particular recipient organization for a tax year, whether such organization is a management organization for such tax year (with respect to either the same or a different recipient organization) or whether such organization becomes a management organization for a subsequent tax year (with

respect to either the same or a different recipient organization) will be determined by a reapplication of the more than 50% test to such organization for the applicable tax year.

B. Insubstantial Management Functions.

1. A management organization does not exist with respect to a particular recipient organization for a tax year of the management organization during which the performance of management functions for such recipient organization, in relation to all services performed for such recipient organization, is not substantial.
2. The performance of management functions for a recipient organization is not substantial for a tax year only if during such tax year less than 50% of the compensation provided by the management organization, with respect to services performed for the recipient organization (including services performed as an employee of the management organization and in any other capacity), is provided to individuals who perform a significant amount of management functions for the recipient organization.
3. An individual performs a significant amount of management functions for the recipient organi-

zation if, during the tax year, at least 15% of the individual's service (including service performed as an employee of the management organization and in any other capacity) for the recipient organization (based on time) is performing management functions for the recipient organization.

4. Compensation means:

- (a) with respect to services performed as a common law employee, compensation reportable on Form W-2; and
- (b) with respect to services performed as a self-employed individual, earned income.

C. Use of Gross Receipts to Determine Principal Business.

1. This determination is made on the basis of the percentage of gross receipts derived from management functions and other services performed for a recipient organization, as compared to the gross receipts derived from all business activities.
2. To determine the two-tax year percentage, gross receipt for the combined two-tax year period are compared.
3. You cannot average the percentages determined separately for each tax year.

4. Gross receipts derived from all business activities do not include gross receipts from the sale of any assets.

D. Use of Facts and Circumstances to Determine Principal Business.

1. The Commissioner has the discretion to determine that the use of gross receipts is not an appropriate method for determining principal business.
2. In such an event, the determination of principal business shall be made on the basis of all relevant facts and circumstances.
3. You should consider the amount of time actually spent by individuals in performing management functions and other services for a recipient organization.
4. The taxpayer may not make the determination that the use of gross receipts is not an appropriate method for determining principal business.

E. Aggregated Organizations with Different Tax Years.

1. Any twelve-month reporting period used at any time by such organization may be used.
2. The twelve month period must be used consistently from year to year.

III. MANAGEMENT FUNCTIONS.

A. In General.

1. Management functions include only those management activities and services historically performed by employees.
2. Management activities and services include determining, implementing, or supervising (or providing advice or assistance in accomplishing any of the foregoing) as to the:
 - (a) Daily business operations:
 - (i) production;
 - (ii) sales;
 - (iii) marketing;
 - (iv) purchasing; and
 - (v) advertising.
 - (b) Personnel:
 - (i) staffing;
 - (ii) training;
 - (iii) supervising;
 - (iv) hiring; and
 - (v) firing.
 - (c) Employee compensation and benefits:
 - (i) salaries and wages;
 - (ii) paid vacations;
 - (iii) paid holidays;
 - (iv) life and health insurance; and

- (v) pensions.
 - (d) Short and long range business planning:
 - (i) product development;
 - (ii) budgeting;
 - (iii) financing;
 - (iv) expansion of operations; and
 - (v) capital investment.
 - (e) Organizational structure and ownership:
 - (i) corporate formation;
 - (ii) stock issues;
 - (iii) dividends;
 - (iv) mergers; and
 - (v) acquisitions.
 - (f) Any other management activity or service.
3. Management activities and services also include professional services that relate to the activities and services described above.
4. In addition, professional services of the same type as the professional services performed by the recipient organization for third parties are deemed to be management activities and services, and are deemed to be management functions regardless of whether such professional services are historically performed by employees.

B. Historically Performed by Employees.

1. Management activities and services are historically performed by employees in a particular business field if it was not unusual for management activities and services of such type to be performed by employees of organizations in that particular business field in the United States on September 3, 1982.
2. If the particular business field did not exist on September 3, 1982, you must look by analogy to similar business fields in existence in the United States on September 3, 1982.
3. If a management activity or service was ever performed by any employee of a particular organization in such business field, the management activity or service is a management activity or service historically performed by employees.
4. Such determination applies for the period beginning on the date such management activity or service was first performed by an employee of that organization and ending on the date five years after such management activity or service is no longer performed by an employee of that organization.