Attribution of ownership in retirement plans

The determination of an organization’s ownership is critical to the administration of a qualified retirement plan. Ownership is used to ascertain whether an organization is considered to be part of a controlled group or an affiliated service group and also is used to determine an individual’s status as a highly compensated employee (HCE) and/or a key employee for nondiscrimination testing and top-heavy purposes, if applicable. In order to understand how to determine ownership, it’s essential to understand the attribution rules and how a family or business relationship may cause a person or organization to be treated as indirectly owning an interest in a business.

The attribution rules applicable to qualified plans generally fall under three sections of the Internal Revenue Code (IRC): Section 1563, Section 318 and Section 267(c). Although the attribution rules are written in terms of stock ownership, the same rules are applied to organizations that aren’t incorporated. For example, partnerships are based on capital or profits interest, limited liability companies (LLCs) are based on membership interests, trusts and estates are based on actuarial interests, and a sole proprietor is treated as owning 100% of his or her business.

**Attribution under IRC Section 1563**

Used in the determination of controlled group status

**Controlled group overview**

- **Parent-subsidiary controlled groups**—A parent-subsidiary relationship exists when a “parent” business owns at least 80% of one or more other businesses (i.e., the subsidiaries). For purposes of a parent-subsidiary controlled group, attribution is limited to attribution from an organization and options to acquire stock directly from a corporation.

- **Brother-sister controlled groups**—A brother-sister relationship exists if the same five (5) or fewer common owners (individuals, trusts or estates) own, directly or indirectly, a controlling interest of 80% in each business and if 50% of the ownership is identical. In determining whether a brother-sister controlled group exists, family attribution is considered in addition to attribution from an organization and options to acquire stock.

- **Combined groups**—A controlled group exists if a business is the parent organization in a parent-subsidiary controlled group and is also part of a brother-sister controlled group. All members of the two groups are considered to be part of one controlled group.
Family attribution rules

Interest owned by parents and their children, interest between spouses, and interest among grandparents and their grandchildren can be subject to attribution.

- A spouse is generally attributed to the other spouse, except for persons legally separated under a divorce decree or decree of separate maintenance. In addition, there is no spousal aggregation under Code Section 1563(e) if the following conditions apply:
  - The spouse doesn’t own directly any stock in such corporation during the taxable year
  - The spouse isn’t a director or employee and doesn’t participate in the management of such corporation at any time during the taxable year
  - No more than 50% of the gross income of the business originates from passive income (i.e., derived from royalties, rents, dividends, interest, and annuities)
  - Such stock isn’t subject to conditions that restrict a spouse’s right to dispose of the stock and that run in favor or the individual or his or her children under age 21

- A minor child’s interest is attributed to a parent. “Minor child” is defined as someone under age 21. Although there may be no attribution between spouses if the stated exceptions apply, a controlled group between spouses may still exist if deemed to have ownership in each parent’s business, assuming each parent owns at least 80% of his or her respective business.

- A parent’s interest is attributed to a minor child

- A parent’s interest is attributed to an adult child (age 21 or older) only if the adult child owns more than 50% of the business

- An adult child’s interest is attributed to a parent only if the parent owns more than 50% of that business

- A grandparent’s interest is attributed to a grandchild (minor or adult) only if the child owns more than 50% (directly or by other attribution) of that business

- A minor or adult grandchild’s interest is attributed to the grandparent only if the grandparent owns more than 50% (directly or by other attribution) of that business

- A legally adopted child of an individual is treated as the individual’s child for attribution purposes

- The direct ownership interest of an individual may be attributed to more than one family member

- A sibling’s interest is not attributed to other siblings

- Double attribution isn’t allowed. To prevent multiple tiers of attribution, once an individual has been attributed ownership interest from a family member, that interest can’t be attributed again from the individual to another family member.

Example

Kim owns 100% of a corporation. Kim’s son, John, is married to Susan. Kim’s ownership is attributed to John, and he’s treated as owning 100% through attribution. John’s interest can’t again be attributed to his wife, Susan.

Organizational attribution rules

Ownership interests are attributed proportionally from:

- A corporation to shareholders who own 5% or more of the value of the stock of the corporation. This applies only to brother-sister controlled groups.

- A partnership to partners who have 5% or more capital or profits interest, whichever is greater. This applies to parent-subsidiary and brother-sister controlled groups.

- A trust to its beneficiaries who have 5% or more actuarial interest. This applies to parent-subsidiary and brother-sister controlled groups.

- An estate that has ownership interest in an organization to its beneficiaries. The term “beneficiary” includes any person entitled to receive property of a decedent pursuant to a will or pursuant to laws of descent and distribution.

Under Code Section 1563 there is no attribution to an organization. For example, if a partner in a partnership has ownership in a corporation, no portion of the partner’s ownership in the corporation is attributed to the partnership. If any person has an option to acquire stock, the person is treated as owning the stock for purposes of the attribution rules.

Attribution under IRC Section 318

Used to determine highly compensated employees, key employees and affiliated service groups

Family attribution rules

An individual is treated as owning any interest that’s owned by the individual’s spouse, children, grandchildren or parents

- A spouse’s interest is attributed to the other spouse. There are no “noninvolvement” exceptions to this rule similar to those found in Code Section 1563(e), which was mentioned previously.

- A child’s interest is attributed to a parent (The child’s age is irrelevant.)

- A parent’s interest is attributed to a child (The child’s age is irrelevant.)

- A grandchild’s interest is attributed to the grandparent (The reverse isn’t true; the ownership interest of a grandparent isn’t attributed to that individual’s grandchild.)

- A sibling’s interest is not attributed to other siblings
• A legally adopted child of an individual is treated as the individual’s child for attribution purposes
• The direct ownership interest of an individual may be attributed to more than one family member
• No double attribution is allowed
• Although the “no double attribution” rules may prevent double attribution through the family attribution rule, ownership attributed under the family attribution rule is taken into account for purposes of other attribution rules

Example
Tom owns 80% of Corporation A, and his spouse, Mary, owns 30% of Corporation B. Tom is attributed Mary’s 30% ownership under the family attribution rules. Tom’s attributed 30% ownership in Corporation B is then attributed to Corporation A, since Tom owns at least 50% of Corporation A. Corporation A is now deemed to be a 30% shareholder of Corporation B by reason of attribution from Mary to Tom and then from Tom to Corporation A. This can affect whether Corporation A and Corporation B are members of an affiliated service group.

Organizational attribution rules
Ownership interests are attributed as follows:
• If a corporation owns stock, whether directly or indirectly, of any other organization, the ownership interest is attributed to any person who owns 50% or more of the value of the stock of the corporation
• Stock owned, directly or indirectly, by or for a partnership is attributed to the partners in proportion to each partner’s interest in the partnership
• Stock owned, directly or indirectly, by or for an estate is attributed to the beneficiaries of the estate in proportion to each beneficiary’s interest in the estate
• Stock owned, directly or indirectly, by or for a trust is attributed to the beneficiaries in the trust in proportion to each beneficiary’s actuarial interest in the trust. Stock owned by a qualified trust under IRC Section 401(a), which is exempt from tax under Section 501(a), including an ESOP, is not attributed to participants in the plan.
• Under Section 318, there is no attribution from an individual to an organization.

If any person has an option to acquire stock, the person is treated as owning the stock for purposes of the attribution rules. For purposes of determining highly compensated employees, key employees and affiliated service groups, the employee’s ownership interest would include ownership attributed to the employee by reason of an option, including an option to acquire stock from the corporation.

Attribution under IRC Section 267(c)
Used to identify certain “disqualified persons” under the IRC Section 4975(e) prohibited transaction rules
• Under the family attribution rules, an individual is treated as owning any interest that is owned, directly or indirectly by his or her family members. These include the individual’s:
  – Spouse
  – Brothers, sisters and half-siblings
  – Ancestors
  – Lineal descendants
• Stock owned, directly or indirectly, by or for a corporation, partnership, estate or trust is considered as owned proportionally by or for all of its shareholders, partners or beneficiaries, regardless of the individual’s ownership
  – For purposes of determining whether a corporation, trust or partnership is a disqualified person under Section 4975(e), the family attribution rule is modified to include spouse, ancestor, lineal descendant and any spouse of a lineal descendant.
• If a partner owns any stock in a corporation, his or her ownership is attributed to his or her other partners
• Under the “no double attribution” rules, stock ownership attributed by a family member or partner is not attributed again from the individual to another family member or to a partner
  – However, stock ownership attributed from a corporation to an individual is treated as owned by the individual for purposes of applying the attribution rule where stock owned, directly or indirectly, by or for a corporation is considered as owned proportionally by or for all its shareholders
### Attribution of ownership summary:

<table>
<thead>
<tr>
<th>Attribution</th>
<th>IRC Section 1563</th>
<th>IRC Section 318</th>
<th>IRC Section 267(c)</th>
</tr>
</thead>
</table>
| How applied | Controlled groups | • Highly compensated employees  
• Key employees  
• 401(a)(9) RMDs  
• Affiliated service groups (ASGs)  
• Leased employee-owners  
• ESOPs  
• Shareholder employees | • Prohibited transactions (disqualified persons)  
• ASG management function groups (related persons) |
<p>| Parent to minor child (less than age 21) | A child is deemed to own a parent’s stock | A child is deemed to own a parent’s stock | A child is deemed to own a parent’s stock |
| Minor child to parent | A parent is deemed to own a child’s stock | A parent is deemed to own a child’s stock | A parent is deemed to own a child’s stock |
| Parent to child aged 21 or older | A child is deemed to own a parent’s stock only if the child owns more than 50% of the business | A child is deemed to own a parent’s stock | A child is deemed to own a parent’s stock |
| Child aged 21 or older to parent | A parent is deemed to own a child’s stock only if the parent owns more than 50% of the business | A parent is deemed to own a child’s stock | A parent is deemed to own a child’s stock |
| Grandchild to grandparent | A grandparent is deemed to own a grandchild’s stock only if the grandparent owns more than 50% of the business | A grandparent is deemed to own a grandchild’s stock | A grandparent is deemed to own a grandchild’s stock |
| Grandparent to grandchild | A grandchild is deemed to own a grandparent’s stock only if the grandchild owns more than 50% of the business | No attribution | A grandchild is deemed to own a grandparent’s stock |
| Other lineal ancestors and descendants | No attribution | No attribution | Lineal ancestors and descendants are deemed to own stock |
| Brothers, sisters and half-siblings | No attribution | No attribution | Lineal ancestors and descendants are deemed to own stock except for purposes of Section 4975 (prohibited transaction tax imposed on disqualified person) |
| Spouses of lineal descendants | No attribution | No attribution | Spouses of lineal ancestors and descendants are deemed to own stock for purposes of Section 4975 |</p>
<table>
<thead>
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<th>IRC Section 1563</th>
<th>IRC Section 318</th>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>C corporation to shareholder</strong></td>
<td>A 5% shareholder is deemed to own a pro rata share of the corporation’s interest in another organization</td>
<td>A 50% shareholder is deemed to own a pro rata share of the corporation’s interest in another organization. Substitute 5% for 50% to determine HCE and key employee</td>
<td>A shareholder is deemed to own a pro rata interest in stock</td>
</tr>
<tr>
<td><strong>S corporation to shareholder</strong></td>
<td>A 5% shareholder is deemed to own a pro rata share of the corporation’s interest in another organization</td>
<td>A stockholder is deemed to own a pro rata interest in stock</td>
<td>A shareholder is deemed to own a pro rata interest in stock</td>
</tr>
<tr>
<td><strong>Partnership to partner</strong></td>
<td>A 5% partner is deemed to own a pro rata share of the partnership’s interest in another organization</td>
<td>A partner is deemed to own a pro rata share of the partnership’s interest in another organization</td>
<td>A partner is deemed to own a pro rata interest in stock</td>
</tr>
<tr>
<td><strong>Partner to partnership</strong></td>
<td>The partnership is deemed to own the interest owned by a partner</td>
<td>The partnership is deemed to own the interest owned by a partner</td>
<td>The partnership is deemed to own the stock</td>
</tr>
<tr>
<td><strong>Partner to partner</strong></td>
<td>No attribution</td>
<td>No attribution</td>
<td>The partner is deemed to own stock</td>
</tr>
<tr>
<td><strong>Estate to beneficiary</strong></td>
<td>A 5% beneficiary is deemed to own a pro rata share of the estate’s actuarial interest in stock</td>
<td>Beneficiaries are deemed to own pro rata shares of the estate’s actuarial interest in stock</td>
<td>Beneficiaries are deemed to own pro rata shares of the estate’s actuarial interest in stock</td>
</tr>
<tr>
<td><strong>Trust to beneficiary</strong></td>
<td>A 5% beneficiary is deemed to own a pro rata share of the trust’s actuarial interest in stock. The grantor of a grantor trust is deemed to own stock of the grantor trust</td>
<td>Beneficiaries are deemed to own pro rata shares of the trust’s actuarial interest in stock</td>
<td>Beneficiaries are deemed to own pro rata shares of the trust’s actuarial interest in stock</td>
</tr>
<tr>
<td><strong>Retirement trust to participant or beneficiary</strong></td>
<td>No attribution</td>
<td>No attribution</td>
<td>Participants and beneficiaries are deemed to own pro rata shares of the trust’s interest in stock</td>
</tr>
<tr>
<td><strong>Holders of options</strong></td>
<td>Holders of options are deemed to own stock</td>
<td>Holders of options are deemed to own stock</td>
<td>No attribution</td>
</tr>
</tbody>
</table>
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