Internal Revenue Service

Number: **201850011**
Release Date: 12/14/2018

Index Number: 414.18-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

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Refer Reply To:
CC:TEGE:EB:QP4
PLR-109716-18

Date:
September 14, 2018

Legend:
Taxpayer A =
Company B =
Plan C =
Year D =
Year E =
Testing Year F =

Dear :

This letter responds to Taxpayer A's request dated March 18, 2018, as supplemented by correspondence dated June 29, 2018, submitted on its behalf by its authorized representative for a determination that Company B satisfies the administrative scrutiny requirement of section 414(r)(2) of the Internal Revenue Code (Code) and the regulations thereunder.

The following facts and representations have been submitted under penalties of perjury in support of Taxpayer A's request:

In Year E, Taxpayer A, a company, acquired Company B. Company B, founded in Year D, is a designer of for the community. Company B provides unique products and services to the community that are distinct from the products and services provided by Taxpayer A.

Since the acquisition, Company B has continued to operate autonomously and has been led by substantially the same leadership team as before the acquisition. Company B operates its business independently from Taxpayer A. While Taxpayer A and Company B serve some of the same customers, Company B enters into separate

contracts with any shared customers. In addition, Company B services customers that Taxpayer A does not.

Company B develops its own business, maintains separate financial records, and is managed by its own chief executive officer and chief financial officer. Company B is governed by its own board of directors. Company B maintains its own human resources department, employee handbook, and policies and procedures. Company B interviews, recruits, and hires its own employees and utilizes its own payroll system. Company B maintains its own time-off policies, leave of absence rules, and severance plan.

Company B maintains its own office space in a location separate from other Taxpayer A entities and leases office space in its own name. Company B also maintains its own technology resources, including its server and network, whereas all other Taxpayer A entities use Taxpayer A's in-house organization to provide these services.

Company B provides its employees with a generous compensation package, including maintaining Plan C, in order to compete for top talent in this highly specialized field. The majority of Company B's direct competitors are also highly specialized companies which offer similar, and in many cases, nearly identical compensation packages.

Taxpayer A represents that Company B meets paragraphs (1) through (3) of section 3.03 of Rev. Proc. 93-41, 1993-2 C.B. 536 (Rev. Proc. 93-41), but fails to satisfy any of the standard access alternatives of paragraph (4) of section 3.03.

Based on the facts and representations stated above, Taxpayer A requests a determination under section 3.04 of Rev. Proc. 93-41 that Company B satisfies the requirement of administrative scrutiny, within the meaning of section 414(r)(2)(C) of the Internal Revenue Code (Code) and § 1.414(r)-6, for Testing Year F.

Section 414(r) generally provides that an employer is treated as operating qualified separate lines of business during any year if the employer operates separate lines of business for bona fide business reasons and satisfies certain other conditions under the Code. If the employer is treated as operating qualified separate lines of business for the year, the employer may apply the minimum coverage requirements of section 410(b) (including the nondiscrimination requirements of section 401(a)(4)) and the minimum participation requirements of section 401(a)(26) separately with respect to employees of each qualified separate line of business.

Section 414(r)(2) provides that each separate line of business must meet certain statutory requirements to be considered a qualified separate line of business. Section 414(r)(2)(A) requires that a line of business have at least 50 employees who are not excluded under section 414(q)(5). Section 414(r)(2)(B) provides that the employer must notify the Secretary that such line of business is being treated as separate. Section 414(r)(2)(C) provides that either such line of business must meet the administrative

scrutiny guidelines prescribed by the Secretary or the employer must receive a determination from the Secretary that such line of business may be treated as meeting administrative scrutiny.

Section 1.414(r)-1 provides that an employer is treated as operating qualified separate lines of business only if: (1) the employer designates its lines of business by reference to the property or services provided by each line of business; (2) each line of business is organized and operated separately from the remainder of the employer; and (3) each of these separate lines of business meets additional statutory requirements (including administrative scrutiny) and thus constitutes a qualified separate line of business.

A separate line of business automatically meets the administrative scrutiny requirement of section 414(r)(2)(C) if it meets the statutory safe harbor of section 414(r)(3)(A). Section 1.414(r)-1 provides that a separate line of business can also automatically meet the administrative scrutiny requirement of section 414(r)(2)(C) if it meets one of the regulatory administrative scrutiny safe harbors in § 1.414(r)-5.

A separate line of business that does not satisfy any of these safe harbors nonetheless satisfies the administrative scrutiny requirement if the employer requests and receives a determination from the Internal Revenue Service (IRS), under a program implemented pursuant to § 1.414(r)-6, that the separate line of business satisfies the administrative scrutiny requirement.

Rev. Proc. 93-41 sets forth the procedures of the IRS relating to the issuance of an administrative scrutiny determination, which is a determination by the IRS as to whether a separate line of business satisfies the requirement of administrative scrutiny within the meaning of § 1.414(r)-6. An employer may request a determination as to whether a separate line of business satisfies the administrative scrutiny requirement under § 1.414(r)-6 for a specified testing year, as defined in § 1.414(r)-11, with respect to a separate line of business described in either section 3.03 or 3.04 of Rev. Proc. 93-41. An employer cannot make a request for a testing year that ends prior to the date of the request.

A separate line of business is described in section 3.03 of Rev. Proc. 93-41 if it:

(1) meets the criteria for a line of business for the testing year under § 1.414(r)-2 and for a separate line of business for the testing year under § 1.414(r)-3;

(2) meets the 50 employee requirement of section 414(r)(2)(A) on each day of the testing year;

(3) does not satisfy any of the administrative scrutiny safe harbors of § 1.414(r)-5(b) through (g); and

(4) satisfies at least one of the following standard access alternatives:

a. The highly compensated employee percentage ratio of the separate line of business for the testing year, as determined under § 1.414(r)-5(b), is at least 40 percent and not more than 250 percent;

b. Ninety percent of the gross revenues of the separate line of business result from the provision of property or services that fall exclusively within one or more industry categories established by the IRS (through Rev. Proc. 91-64, 1991-2 C.B. 866), under § 1.414(r)-5(c), and no more than ten percent of the gross revenues of any of the employer's other separate lines of business result from property or services provided to customers of the employer that fall within the same industry category or categories;

c. The employer is not required to file Form 10-K or 20-F, but there is a certification from an independent certified public accountant that the employer would have been required to report the separate line of business as one or more reportable industry segments on either the Form 10-K or the Form 20-F if the employer had been required to file the applicable Securities and Exchange Commission (SEC) report for the employer's fiscal year ending in the testing year, and the separate line of business therefore would have satisfied the administrative scrutiny safe harbor in § 1.414(r)-5(e);

d. The separate line of business has a highly compensated employee percentage ratio, as determined under § 1.414(r)-5(b), of less than 40 percent, and either (i) the separate line of business would satisfy the average benefits safe harbor of § 1.414(r)-5(f)(2)(ii) if the actual benefit percentage of the nonhighly compensated employees of the other separate lines of business were reduced by one-third, or (ii) the separate line of business would satisfy the minimum benefit safe harbor of § 1.414(r)-5(g) if the minimum benefit were reduced by one-third;

e. The separate line of business has a highly compensated employee percentage ratio, as determined under § 1.414(r)-5(b), of more than 250 percent, and either (i) the separate line of business would satisfy the average benefits safe harbor of § 1.414(r)-5(f)(3)(ii) if the actual benefit percentage of the highly compensated employees of the other separate lines of business were increased by one-third, or (ii) the separate line of business would satisfy the maximum benefit safe harbor of § 1.414(r)-5(g) if the maximum benefit were increased by one-third; or

f. The separate line of business manages a government facility pursuant to a government contract that specifies the benefits to be provided under a qualified plan.

In accordance with section 4.03 of Rev. Proc. 93-41, for a separate line of business determination described in section 3.03, the IRS takes into account the factors enumerated in section 5 and any other relevant facts and circumstances in determining whether such separate line of business satisfies administrative scrutiny. No one factor is necessarily determinative.

The factors listed in section 5 of Rev. Proc. 93-41 are as follows:

(1) Differences in property or services: The degree to which the property or services provided by the separate line of business differ from the property or services provided by the employer's other separate lines of business.

(2) Separateness of organization and operation: The degree to which the separate line of business is organized and operated separately from the remainder of employer, including the degree of vertical integration of the separate line of business with any other separate line of business of the employer and the degree to which the separate line of business has its own tangible assets.

(3) Nature of business competition: The nature of the business competition faced by the separate line of business, the degree to which competitors of the separate line of business are organized as independent stand-alone companies that do not engage in other separate lines of business, and the type and level of benefits provided by competitors of the separate line of business to their employees.

(4) Historical factors: Whether the separate line of business was acquired from another employer, whether it developed separately within the employer, and whether it was operated separately before the enactment of the Tax Reform Act of 1986.

(5) Geographic factors: The degree to which the separate line of business is operated in a distinct geographic area from the employer's other separate lines of business, and the impact geographic factors have on the employer's compensation and benefit policies.

(6) Safe harbors: The degree to which the separate line of business fails to satisfy the safe harbors of § 1.414(r)-5, in particular, the average benefits and minimum or maximum benefits safe harbors of §§ 1.414(r)-5(f) and (g).

(7) Size and Composition: The size and composition of the separate line of business relative to each of the employer's other separate lines of business. This factor

includes the number of employees, both highly compensated and nonhighly compensated, and the highly compensated employee percentage ratio (as determined under § 1.414(r)-5(b)), in each of the employer's separate lines of business (whether or not a separate line of business for which an administrative scrutiny determination is being requested) as determined for purposes of § 1.414(r)-7.

(8) Allocation method: Which allocation method for residual shared employees the employer applies under § 1.414(r)-7(c), and the impact the allocation method will have on the number of employees who are treated as employees of each of the employer's separate lines of business.

(9) Benefits provided by separate lines of business: The relative level of benefits provided by each of the employer's separate lines of business and the percentage of employees benefiting in each of the employer's separate lines of business.

(10) Other separate lines of business: The degree to which the employer's other separate lines of business satisfy the requirements of a qualified separate line of business for the testing year under § 1.414(r)-1(b)(2).

(11) Regulated industries: Whether the separate line of business operates in a regulated industry (i.e., whether the separate line of business furnishes or sells electrical energy, water or sewage disposal services; gas or steam through a local distribution system; telephone service or other communication services; or transportation of gas or steam by pipeline) if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.

Section 3.04 of Rev. Proc. 93-41 provides that a line of business is described in section 3.04 if it meets paragraphs (1) through (3) of section 3.03, but fails to satisfy any of the standard access alternatives of paragraph (4) of section 3.03.

In accordance with section 4.04 of Rev. Proc. 93-41, for a separate line of business determination described in section 3.04, the IRS will scrutinize all the relevant facts and circumstances (including factors enumerated in section 5) more closely in determining whether a separate line of business satisfies administrative scrutiny, and the IRS will determine that the separate line of business satisfies administrative scrutiny only in exceptional circumstances. In such case, the taxpayer has an additional burden to demonstrate to the IRS the relevant facts and circumstances unique to the taxpayer to support a determination that the separate line of business meets administrative scrutiny, despite its failure to satisfy any of the standard access alternatives.

Based on the facts provided, we have made a determination under section 3.04 of Rev. Proc. 93-41 that Company B satisfies the requirement of administrative scrutiny, within the meaning of section 414(r)(2)(C) and § 1.414(r)-6, for Testing Year F.

This determination relates only to the status of the above-referenced line of business under the administrative scrutiny requirement of section 414(r) and the regulations thereunder, and does not constitute a determination as to whether the line of business satisfies any other requirement under section 414(r).

This determination does not constitute a determination with respect to whether any plan of the above-referenced line of business is qualified under section 401(a) or whether it meets any other requirement under the Code or regulations.

This determination will apply to the Testing Year F and future testing years. However, this determination may not be relied upon if there has been a misstatement or omission of material facts. Similarly, this determination may not be relied upon if there has been a change in material fact upon which it is based.

No information provided in support of a request for an administrative scrutiny determination will constitute actual or constructive notice to the Secretary, as required under section 414(r)(2)(B), that an employer treats itself as operating qualified separate lines of business for a testing year. Such notice is provided by filing Form 5310-A, *Notice of Plan Merger or Consolidation, Spinoff, or Transfer of Plan Assets or Liabilities; Notice of Qualified Separate Lines of Business*, in the manner specified in Rev. Proc. 93-40, 1993-2 C.B. 535.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party, as specified in Rev. Proc. 2018-1, 2018-1 I.R.B. 1, section 7.01(16)(b). This office has not verified any of the material submitted in support of the request for ruling, and such material is subject to verification on examination. The Associate office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based; or, in the case of a transaction involving a continuing action or series of actions, the controlling facts change during the course of the transaction. *See* Rev. Proc. 2018-1, section 11.05.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Joyce Kahn
Branch Chief
Qualified Plans Branch 4
Office of Associate Chief Counsel
(Tax Exempt & Government Entities)