

D. Ownership Attribution Rules Under Code §318

For certain tax purposes, a person's or entity's ownership interest is considered to be assigned to a related family member or entity under a tax concept known as “attribution.” Rules governing attribution appear in several places in the Code. Some of the more familiar rules appear in Code §§414(b), 414(c), 414(m), and 1563(a)—these are known as the controlled group rules. (See Section XXVIII for details.) Other Code provisions contain special attribution rules, such as those under Code §129(e)(5) for DCAPs. A third set of attribution rules, which is the subject of this subsection D, are those under Code §318, regarding constructive ownership of stock. The Code §318 rules only apply to those provisions in the Code that expressly make them applicable.

Code §318 contains several attribution rules, including the following (among others):

- an individual is deemed to own the interest held by his or her spouse (other than one who is legally separated under a decree of divorce or separate maintenance), children, grandchildren, and parents;
- if a person has an option to acquire stock, then the stock subject to that option is considered to be owned by that person;
- a partner is deemed to own a proportionate amount of any interest held by the partnership;
- and a shareholder who owns 50% or more of a corporation is deemed to own a proportionate share of stock owned by the corporation.

However, stock owned by a qualified plan (such as stock held in an ESOP) is not considered to be owned by the individual under the Code §318 rules, even if it is allocated to the participant's account.

Who Is a Spouse? As used in this discussion and for federal tax purposes, the term “spouse” includes all legally married same-sex or opposite-sex spouses. Individuals in registered domestic partnerships, civil unions, or similar relationships are not considered spouses for this purpose. The rules for determining who is a spouse are discussed in Section XI.

If the entity is a corporation, ownership interest is measured by stock ownership. If the employer is a partnership or other form of business entity, ownership is determined on the basis of capital or profits interest in the employer. Generally, once someone is considered to own an interest (that is, has the interest attributed), that person is considered to actually own it. But if a family member or entity is considered to own an interest through attribution, the individual or entity is not considered to own it for purposes of attributing it to another. In other words, there generally is no re-attribution.

For cafeteria plans, the issue of whether the Code §318 rules apply is relevant in two contexts: (1) eligibility to participate in a cafeteria plan (see subsections A through F); and (2) nondiscrimination testing of cafeteria plans and their component benefits.