Uniform Issue List No.. 409.01-09

200111053

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Person To Contact:

Telephone Number:

Refer Reply To:
T:EP:RA:T3
Date: *December 21, 2000*

LEGEND:

Company A:

Subsidiary 1:

Plan X:

Dear

This is in response to a request for a private letter ruling, dated July 13, 2000, as supplemented by a letter dated December 21, 2000, submitted on your behalf by your authorized representative, concerning the applicability of section 409(l)(4) of the Internal Revenue Code to an employee stock ownership plan. Your authorized representative submitted the following facts and representations in support of the request.

Company A is a member of a controlled group of corporations as defined in sections 414(b), (c), and (m) of the Internal Revenue Code ("Code"). The controlled group consists of Company A and its United States subsidiaries, including Subsidiary 1. In 2000, Company A reorganized its corporate structure in order to integrate one of its corporate acquisitions and to provide more flexibility in structuring its business operations. As part of the restructuring, Company A intends to form a new limited liability corporation ("LLC"). Subsidiary 1, a wholly-owned subsidiary of Company A, will be the sole member of the LLC. The LLC will not make an election under section 301.7701-3(a) of the Treasury Regulations to be taxed as a corporation. Therefore, under section 301.7701-3(b)(1)(ii) of the regulations, the LLC will be treated as a disregarded entity.

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Company A currently maintains Plan X for the benefit of its employees and the employees of its subsidiaries. The portion of Plan X that is attributable to deferred compensation contributions and regular contributions, as those terms are defined in Plan X, is a profit sharing plan. Effective July 5, 1989, the portion of Plan X attributable to company contributions, as defined in Plan X, was designed to be invested primarily in Company A common stock which is readily tradable on an established securities market within the meaning of Code section 409(l). Plan X constitutes an employee stock ownership plan within the meaning of Code section 4975(e)(7) and is qualified under Code section 401(a).

Based on the above facts and representations, your authorized representative has requested the following rulings:

1. Employees of the LLC, a disregarded entity solely owned by a member of Company A's controlled group, will be treated as part of Company A's controlled group for purposes of Code section 1563(a) as it relates to section 409(l)(4).

2. The common stock of Company A will not fail to satisfy the definition of "employer securities" as that term is defined under Code section 409(l) with respect to employees of the LLC.

Two other requested rulings were addressed in a separate letter ruling.

Code section 4975(e)(7) provides in pertinent part that an employee stock ownership plan must be designed to invest primarily in "qualifying employer securities" which is defined in section 4975(e)(8) as any employer security within the meaning of section 409(l).

Code § 409(l)(1) defines the term "employer securities" as common stock issued by the employer (or by a corporation that is a member of the same controlled group) which is readily tradable on an established securities market.

Code section 409(l)(4)(A) states that for purposes of this subsection, the term "controlled group of corporations" has the meaning given to such term by section 1563(a) (determined without regard to subsections (a)(4) and (e)(3)(C) of section 1563) [pertaining to certain insurance companies and constructive ownership, respectively].

The definition of a controlled group is found in Code section 1563. Section 1563 defines two basic types of controlled corporate groups: (1) the parent-subsidiary controlled group, and (2) the brother-sister controlled group.

A parent-subsidiary controlled group exists when one or more chains of corporations are connected through stock ownership with a common parent corporation if, stock possessing at least 80 percent of the voting power or value of the stock of each corporation in the group other

than the parent is owned by one or more corporations in the group, and the common parent owns stock possessing at least 80 percent of the voting power or value of the stock of one of the other corporations in the group (not counting stock owned directly by other members of the group) (Code section 1563(a)(1)).

A brother-sister controlled group exists if two ownership tests are met. First, the same five or fewer persons must own more than 50 percent of the voting stock or value of shares of two or more corporations, considering a particular person's stock only to the extent that it is owned identically with regard to each corporation. Second, the same five or fewer individuals must own at least 80 percent of the voting stock or value of shares of each corporation, considering a particular person's stock *only* if that person owns stock in each member of the controlled group (Code section 1563(a)(2)).

Subsidiary 1, a wholly-owned subsidiary of Company A, is the sole member of the LLC. The LLC will not make an election under section 301.7701-3(a) of the regulations to be taxed as a corporation; instead, it will be classified by default under section 301.7701-3(b)(1)(ii) as a disregarded entity for Federal income tax purposes. Under section 301.7701-2(a) the LLC will be regarded as a division of Subsidiary 1, with the LLC's assets and liabilities attributed to Subsidiary 1.

Therefore, as the LLC has no existence independent of Subsidiary 1 for Federal income tax purposes, it cannot be considered a member of Company A's controlled group. However, as the LLC's assets and liabilities are attributed to Subsidiary 1, and Subsidiary 1 is a member of Company A's controlled group, employees of the LLC should be treated as if they were employed by Subsidiary 1, for purposes of section 1563.

As previously stated, Subsidiary 1 is a member of Company A's controlled group. Accordingly, with respect to your first requested ruling, we conclude that employees of the LLC, a disregarded entity solely owned by a member of Company A's controlled group, will be treated as part of Company A's controlled group for purposes of Code section 1563(a) as it relates to section 409(l)(4).

With respect to your second requested ruling, Code section 409(l)(1), as previously stated, defines the term "employer securities" as common stock issued by the employer (or by a corporation which is a member of the same controlled group) which is readily tradable on an established securities market. Section 409(l)(4) generally states that the term "controlled group of corporations" has the meaning given to such term by section 1563(a). We have ruled above that the employees of the LLC will be treated as part of Company A's controlled group for purposes of section 1563(a).

Accordingly, with respect to your second requested ruling, we conclude that the common stock of Company A will not fail to satisfy the definition of "employer securities" as that term is defined under Code section 409(l) with respect to the employees of the LLC.

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This ruling letter is based on the assumption that Plan X continues to be otherwise qualified under Code sections 401(a) and 4975(e)(7) at all relevant times.

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

Copies of this ruling letter have been sent to your authorized representatives in accordance with a power of attorney on file with this office.

Sincerely yours,

Frances V. Sloan

Frances V. Sloan, Manager
Employee Plans Technical Group 3
Tax Exempt and Government Entities Division

Enclosures
Notice 437
Deleted copy of ruling letter