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Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Person To Contact:

Telephone Number:

Refer Reply To: T:EP:RA:T3

Date: JAN 24 2001

LEGEND:

Company A:

Company B:

First-Tier Subsidiaries:

Second-Tier Subsidiaries:

246

Third-Tier Subsidiaries:

Fourth-Tier Subsidiaries:

Plan X:

Dear

This is in response to a request for a private letter ruling, dated June 16, 2000, as supplemented by a letter dated January 9, 2001, submitted on your behalf by your authorized representative, concerning the applicability of section 409(l)(4) of the Internal Revenue Code

("Code") to an employee stock ownership plan. Your authorized representative submitted the following facts and representations in support of the request.

Company B, the parent company, is a holding company that directly and indirectly owns the First, Second, Third and Fourth Tier Subsidiaries ("Subsidiaries"). All of the First Tier Subsidiaries are wholly-owned subsidiary corporations of Company B. Company B and all of its corporate Subsidiaries constitute a parent-subsidiary controlled group within the meaning of Code section 1563. All of the non-corporate Subsidiaries are single owner limited liability companies ("LLC's") organized under applicable state law.

Company A is a First Tier Subsidiary of Company B. Company A has maintained Plan X since January 1, 1975. The Internal Revenue Service has determined that Plan X, in form, is an "employee stock ownership plan" as described in Code section 4975(e)(7) and meets the requirements of section 401(a) of the Code. The assets of Plan X consist exclusively of shares of Company B common stock which is readily tradable on an established securities market within the meaning of Code section 409(l).

Each LLC has a single corporate owner, or is owned by a single LLC with a single corporate owner. One of these corporate owners is a Second Tier Subsidiary that is wholly owned by a First Tier Subsidiary; all of the other corporate owners are First Tier Subsidiaries. None of the LLC's made an election under section 301.7701-3(c) of the Income Tax Regulations to be classified as a corporation for federal tax purposes. Instead, all of the LLC's have accepted the default classification of section 301.7701-3(b) of the regulations, resulting in their being disregarded as entities separate from their corporate owners.

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

(1) Unless and until an election is made to change the classification of the LLC's, the employees of the LLC's will be treated as part of Company B's controlled group for purposes of Code section 1563(a), as it relates to Code section 409(l)(4)

(2) Shares of common stock of Company B will not fail to satisfy the definition of "employer securities" under section 409(l) of the Code with respect to employees of the LLC's.

(3) Any entity in Company B's corporate organization immediately after the restructuring that in the future elects to be treated as a corporation for Federal income tax purposes under section 7701 of the Code will continue to be a part of the group of controlled corporations under section 1563 of the Code that includes Company B (determined without regard to subsections (a)(4) and (e)(3)(C)) and shares of common stock of Company B will continue to constitute "employer securities" under section 409(l) of the Code with respect to such entity.

(4) Any entity in Company B's corporate organization immediately after the restructuring that in the future revokes an election to be treated as a corporation for federal income tax purposes under section 7701 of the Code will continue to be a part of the group of controlled corporations under section 1563 of the Code (determined without regard to subsections (a)(4) and (e)(3)(C)) that includes Company A and shares of common stock of Company A will continue to constitute "employer securities" under section 409(l) of the Code with respect to such entity.

(5) Any domestic entity that may hereafter be organized or created that is included in the Company B's corporate organization that is a "disregarded entity" under section 7701 of the Income Tax Regulations or that properly elects to be treated as a corporation for Federal income tax purposes under section 7701 of the Income Tax Regulations will be included in the group of controlled corporations under section 1563 of the Code that includes Company A (determined without regard to subsections (a)(4) and (e)(3)(C)) and shares of common stock of Company A will constitute "employer securities" under section 409(l) of the Code with respect to such entity.

With respect to the first and second requested rulings, 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 section 409(l)(1) 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.

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].

Code section 1563(a) provides that a parent-subsidiary controlled group is any group of "one or more chains of corporations" meeting certain requirements. Section 7701(a)(3) defines "corporation" to include associations, joint-stock companies, and insurance companies. Section 301.7701-2(b) elaborates upon the list of entities qualifying as "corporations". The regulations under section 7701 allow single owner organizations to choose to be recognized or disregarded as entities separate from their owners for all federal tax purposes. If an election is not made, the association will be disregarded as an entity separate from its owner for all purposes of the Code and deemed to liquidate by distributing its assets and liabilities to its sole owner.

The LLC's do not qualify as corporations under either Code section 7701(a)(3) or section 301.7701-2(b) of the regulations, because both sections require that a corporation have entity status. The LLC's have chosen to be disregarded entities and thus are no longer treated as separate from their corporate owners for all federal tax purposes. Instead, each is regarded as a

division of its corporate owner. Since Code section 1563(a) requires that a controlled group consist of corporations, the LLC's are not "members" of Company B's parent-subsidiary controlled group.

On the other hand, the assets and liabilities of the LLC's are included in Company B's parent-subsidiary controlled group. A disregarded entity is treated as having liquidated by distributing all of its assets and liabilities to its single owner. When a disregarded entity is owned by another disregarded entity, the assets and liabilities of a lower tier disregarded entity are deemed to be owned by the higher tier disregarded entity, which in turn are deemed to be owned by the higher tier disregarded entity's sole owner. See section 301.7701-2(a) of the regulations.

As applied to the facts at issue, the assets and liabilities of the LLC's are ultimately deemed to be owned by one of the First or Second Tier Subsidiaries. All of these owners are currently members of Company B's parent-subsidiary controlled group. Their ownership of the assets and liabilities of the LLC's in lower tier Subsidiaries will result in those assets and liabilities being part of Company B's controlled group even though these LLC's are not "members" of Company B's parent-subsidiary controlled group. Therefore, employees of the LLC's in the Second through Fourth Tier Subsidiaries will be treated as employees of those Subsidiaries which are part of Company B's controlled group.

Accordingly, with respect to your first requested ruling, we conclude that unless and until an election is made to change the classification of the LLC's, the employees of the LLC's will be treated as part of Company B's controlled group for purposes of Code section 1563(a), as it relates to Code section 409(l)(4).

Therefore, with respect to your second requested ruling, we conclude that shares of common stock of Company B will not fail to satisfy the definition of "employer securities" under section 409(l) of the Code with respect to employees of the LLC's.

With respect to the third, fourth and fifth requested rulings, section 7.02 of Rev. Proc. 2000-1, 2000-1 IRB 21, states that a letter ruling will not be issued on alternative plans of proposed transactions or on hypothetical situations. As the third, fourth and fifth requested rulings are hypothetical, we are constrained not to rule by the revenue procedure cited above.

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.

The original of this ruling letter has been sent to your authorized representative 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

Original to