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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply to:

Date: OP:E:EP:T:3

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LEGEND:

Company A:

Subsidiary 1:

Subsidiary 2:

Subsidiary 3:

Subsidiary 4:

Subsidiary 5:

Subsidiary 6:

Subsidiary 7:

Plan X:

Dear

This is in response to a request for a private letter ruling, dated March 26, 1999, as amended by a letter dated June 2, 1999, 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 holding company that, through its corporate subsidiaries, owns, operates, and/or manages certain recreational facilities and related real estate through sole ownership,

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partial ownership (including joint venture interests), and management agreements. Company A maintains Plan X for the benefit of the employees of its subsidiaries. Plan X is an employee stock ownership plan as described in Code section 4975(e)(7) which is also qualified under Code section 401(a). Plan X is designed to invest primarily in Company A stock.

Subsidiary 1 is a wholly-owned first-tier subsidiary of Company A. Company A owns 100% of all classes of stock of Subsidiary 1. Subsidiary 2 is a single member limited liability company owned by Subsidiary 1. Subsidiary 2 has not and will not be making an election under section 301.7701-3(c) of the Income Tax Regulations to be classified as a corporation for federal tax purposes. Rather, Subsidiary 2 will accept the default classification of section 301.7701-3(b) of the regulations, resulting in the association being disregarded as an entity separate from its corporate owner. Subsidiaries 3, 4, 5 and 6 are third-tier, single member limited liability companies with Subsidiary 2 as their sole member. Subsidiaries 3, 4, 5 and 6 have not and will not be making an election under section 301.7701-3(c) of the regulations to be classified as corporations for federal tax purposes. They too will be accepting the disregarded entity default classification of section 301.7701-3(b) of the regulations. Subsidiary 7 is a third-tier, single member limited liability company, with Subsidiary 2 as its sole member. Subsidiary 7 has elected under section 301.7701-3(c) of the regulations to be classified as an association taxable as a corporation for federal tax purposes.

Company A's controlled group presently consists of Company A, Subsidiary 1 and other subsidiaries of Company A which are not relevant to this restructuring.

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 Subsidiaries 2, 3, 4, 5 and 6 (collectively, the "Single Member Disregarded Entities"), the employees of the Single Member Disregarded Entities will be treated as part of Company A's controlled group for purposes of Code section 1563(a), as it relates to Code section 409(l)(4).

2. Notwithstanding the election by Subsidiary 7 to be treated as an association taxable as a corporation for federal tax purposes, the employees of Subsidiary 7 will be treated as part of Company A's controlled group for purposes of Code section 1563(a), as it relates to Code section 409(l)(4).

3. The common stock of Company A will not fail to satisfy the definition of employer securities under Code section 409(l) with respect to the employees of Single Member Disregarded Entities and employees of Subsidiary 7 by reason of the participation of such employees.

With respect to the first requested 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 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.

Subsidiaries 2 through 6 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. Subsidiaries 2 through 6 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, Subsidiaries 2 through 6 are not "members" of Company A's parent-subsidiary controlled group.

On the other hand, the assets and liabilities of Subsidiaries 2 through 6 are included in Company A'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 Subsidiaries 3 through 6 (third-tier disregarded entities) will be considered to be owned by Subsidiary 2 (second-tier disregarded entity). Since Subsidiary 2 is itself a disregarded entity, the assets and liabilities of Subsidiary 2, which include the assets and liabilities of Subsidiaries 3 through 6, will be deemed to be owned by Subsidiary 2's owner, Subsidiary 1. Subsidiary 1 is currently a member of Company A's parent-subsidiary controlled group. Therefore, Subsidiary 1's ownership of the assets and liabilities of Subsidiaries 2 through 6 will result in those assets and liabilities being part of Company A's controlled group even though Subsidiaries 2 through 6 are not "members" of Company A's parent-subsidiary controlled group.

Provided that Subsidiaries 2 through 6 are single member limited liability companies and have not elected to be treated as corporations for federal tax purposes, they are disregarded as entities separate from their owner and treated as divisions of their owner with their assets and liabilities attributed to their corporate owner. Thus, Subsidiaries 2 through 6 will not be "members" of Company A's parent-subsidiary controlled group as described in Code section 1563(a), but the assets and liabilities of Subsidiaries 2 through 6 will be included in Company A's controlled group because they will be treated as those of Subsidiary 1. Therefore, employees of Subsidiaries 2 through 6 will be treated as employees of Subsidiary 1, which is part of Company A's controlled group.

Accordingly, we conclude with respect to your first requested ruling that, unless and until an election is made to change the classification of Subsidiaries 2 through 6, the employees of Subsidiaries 2 through 6 will be treated as part of Company A's controlled group for purposes of Code section 1563(a), as it relates to Code section 409(l)(4).

With respect to your second requested ruling, Code section 1563(a)(1) provides that a parent-subsidiary controlled group is any group of one or more chains of corporations connected through stock ownership with a common parent corporation provided at least 80% of the total combined voting power of all classes of stock entitled to vote or at least 80% of the total value of all classes of stock of each of the corporations, except the common parent corporation, is owned by one or more of the other corporations in the group; and provided the common parent corporation owns at least 80% of the total combined voting power of all classes of stock entitled to vote or at least 80% of the total value of all classes of stock of at least one of the other corporations excluding, in computing such voting power or value, stock owned directly by such other corporations.

Subsidiary 7 has elected to be classified as a corporation for federal tax purposes. Therefore, in order to be a "member" of Company A's parent-subsidiary controlled group, Subsidiary 7 must have at least 80% of its voting power or at least 80% of the value of its stock owned by one or more corporations within Company A's controlled group, in accordance with Code section 1563(a)(1).

Subsidiary 2 holds 100% of the stock of Subsidiary 7. Subsidiary 2's assets and liabilities will be treated as owned by its corporate owner, Subsidiary 1. Therefore, Subsidiary 1 will be regarded as owning 100% of Subsidiary 7. Since Subsidiary 1 is currently a "member" of Company A's parent-subsidiary controlled group and will hold at least 80% of the voting power of Subsidiary 7, it follows that Subsidiary 7 is also part of Company A's parent-subsidiary controlled group for purposes of Code section 1563(a).

Accordingly, we conclude with respect to your second requested ruling that, notwithstanding the election by Subsidiary 7 to be treated as an association taxable as a corporation for federal tax purposes, the employees of Subsidiary 7 will be treated as part of Company A's controlled group for purposes of Code section 1563(a), as it relates to Code section 409(l)(4).

With respect to your third 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 Single Member Disregarded Entities (Subsidiaries 2 through 6) and Subsidiary 7 will be treated as part of Company A's controlled group for purposes of section 1563(a). Therefore, with respect to your third requested ruling, we conclude that the common stock of Company A will not fail to satisfy the definition of employer securities under Code section 409(l) with respect to the employees of Single Member Disregarded Entities and employees of Subsidiary 7 by reason of the participation in Plan X of such employees.

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.

A copy 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
Chief, Employee Plans
Technical Branch 3

Enclosures
Notice 437
Deleted copy of ruling letter

Cc: