

**INTERNAL REVENUE SERVICE**

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August 14, 2000.

LEGEND:

Company =

L.L.C. =

Partnership =

Corporation A =

Corporation B =

Plan =

This is in reply to a letter dated June 14, 2000, that was submitted on behalf of Company by its authorized representative, in which rulings are requested that, with respect to its own employees who participate in the Plan, Partnership is an "employer corporation," as that term is used in sections 421 through 424 of the Internal Revenue Code; that, while the requisite stock-ownership requirement is met, Partnership is a "subsidiary corporation," as defined in section 424(f); and that, for purposes of the Plan, Company is the employer of L.L.C.'s employees.

The facts submitted are that Company owns 100 percent of L.L.C., which in turn owns all of Corporation A and all of Corporation B. Corporation A owns 99 percent of Partnership, and Corporation B owns one percent of Partnership. It is represented that, under the rules of section 301.7701-3(a) of the Procedural Income Tax Regulations, L.L.C. has elected to be disregarded for federal tax purposes (its assets are considered

to be owned by Company), pursuant to the default classification under section 301.7701-3(b). It is also represented that, under section 301.7701-3(a), Partnership has elected to be classified as an association taxable as a corporation. Additionally, it is represented that the Plan qualifies as an "employee stock purchase plan," as defined in section 423(b) of the Code, under which options for shares of Company's common stock will be granted to employees of Company and employees of its subsidiary corporations.

In pertinent portion, section 421(a) of the Code provides that, if a share of stock is transferred to an individual in a transfer in which the requirements of section 423(a) are met, no income shall result to the individual at the time of the transfer, no deduction under section 162 shall be allowable at any time to the employer corporation with respect to the share transferred, and no amount other than the price paid under the option shall be considered as received by the employer corporation for the share transferred.

Section 423(a) of the Code provides that section 421 will apply to the transfer of a share of stock to an individual pursuant to the exercise of an option granted under an employee stock purchase plan if (1) no disposition of the stock is made by the individual within two years after the date of grant of the option nor within one year after the transfer of such share to him or her, and (2) at all times during the period beginning with the date that the option is granted and ending 3 months before the date of its exercise, the optionee remains an employee of the granting corporation, a parent or subsidiary corporation of such corporation, or a corporation (or parent or subsidiary corporation of such corporation) issuing or assuming a stock option in a transaction to which section 424(a) applies. Section 1.421-7(h) of the regulations provides that, for purposes of these determinations, the question of whether an individual is an "employee" of a particular entity is decided under the rules contained in section 3401(c) of the Code and the regulations thereunder.

For purposes of sections 421 through 424 of the Code, section 424(f) defines the term "subsidiary corporation" as any corporation (other than the employer corporation) in an unbroken chain of corporations beginning with the employer corporation if, at the time of the granting of the option, each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

Section 301.7701-2(b)(2) of the regulations defines a "corporation" as an association as determined under section 301.7701-3. Section 301.7701-3(a) provides that a business entity that is not classified as a corporation under sections 301.7701-2(b)(1) and -2(b)(3) through (8) is an "eligible entity" that may elect its classification for federal tax purposes. An eligible entity with at least two members may elect to be classified as either an association or a partnership. An eligible entity with a single member may elect to be classified as an association or to be disregarded as an entity separate from its owner.

Accordingly, based on the above information and Company's representations, and provided that the described elections are and remain valid, we rule as follows:

- (1) With respect to its own employees who participate in the Plan (as determined under the rules of section 1.421-7(h) of the regulations), Partnership is an "employer corporation," as that term is used in sections 421 through 424 of the Code;
- (2) While the requisite 50-percent stock-ownership requirement is maintained, Partnership is a "subsidiary corporation," as defined in section 424(f); and
- (3) For purposes of the Plan, Company is the employer of L.L.C.'s employees to the extent that such employees would be considered to be the employees of Company under the rules of sections 1.421-7(h) and 301.7701-3 of the regulations.

Except as ruled above, no opinion is expressed regarding the federal tax consequences of the transaction described above under any provision of the Internal Revenue Code. In particular, we specifically note that no opinion is expressed regarding the treatment, under sections 421 through 424 of the Code, of either the Plan or of options granted under the Plan; that, except as stated above, no opinion is expressed regarding application of the rules of section 1.421-7(h) to the circumstances described above; and that no opinion is expressed regarding the parties' federal employment tax obligations relative thereto. Additionally, please note that the above rulings will continue to apply only while the described elections remain in effect.

A copy of this letter must be attached to any income tax return to which it is relevant. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

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

Sincerely yours,  
ROBERT B. MISNER  
Assistant Chief, Branch 1  
Office of the Division Counsel /  
Associate Chief Counsel  
(Tax Exempt and Government Entities)

Enclosures (2):  
Copy of this letter  
Copy for 6110 purposes