

**Internal Revenue Service**

Number: **200601016**

Release Date: 1/6/2006

Index Number: 1504.00-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:B02

PLR-137079-05

Date:

October 3, 2005

In Re

Foreign Parent =

US Parent =

Sub 1 =

Sub 2 =

Country X =

State Y =

ww =

Business A =

Department =

Agency =

Date 1 =

Dear :

This letter responds to your June 28, 2005 request for rulings on behalf of the above-referenced taxpayer. Additional information was submitted on August 17, 2005. The information submitted for consideration is summarized below.

US Parent, a State Y corporation, is the common parent of an affiliated group that files a federal income tax return on a consolidated basis. Sub 1, a State Y corporation, is a wholly owned subsidiary of US Parent. US Parent acquired all of the outstanding stock of Sub 2, a State Y Corporation, on Date 1. Thereafter, US Parent transferred all of the Sub 2 stock to Sub 1. Foreign Parent, a Country X corporation, owns ww percent of the stock of US Parent.

Sub 1 and its direct and indirect subsidiaries, including Sub 2, plan to engage in Business A with Department. In order to perform certain contracts, Sub 1 and its direct and indirect subsidiaries will require security clearances granted by Department pursuant to a program overseen by Agency. Because Foreign Parent owns ww percent of US Parent's stock and because US Parent wholly owns Sub 1's stock, Department requires that Sub 1 be effectively insulated from foreign ownership, control, or influence in order to maintain those clearances.

In order to create a security measure designed to insulate Sub 1 from any foreign control or influence that might arise from US Parent's ownership of stock in Sub 1, US Parent, Sub 1, and Department have entered into a proxy agreement (the "Agreement"). Pursuant to the Agreement, US Parent will select all of the initial proxy holders, who will be citizens of the United States and who will receive voting control of the stock of Sub 1 (the "Proxy Holders"). The Proxy Holders will have all rights, powers, and authority to exercise all voting rights with respect to the Sub 1 stock, subject to the terms and conditions set forth in the Agreement. In particular, the Proxy Holders will have the right to elect the board of directors of Sub 1.

The Proxy Holders will not be permitted to undertake certain major corporate actions without US Parent's express written approval. These include: (1) the sale or disposal, in any manner, of the capital assets or business of Sub 1; (2) the pledging, mortgaging, or encumbering of the assets of Sub 1 for purposes other than obtaining working capital or funds for capital improvements; (3) any merger, consolidation, reorganization, or dissolution of Sub 1; and (4) the filing by Sub 1 of any petition under the federal bankruptcy laws or any similar law of any state or foreign country. Moreover, at US Parent's written request, the Proxy Holders must take such actions as are necessary to recommend, authorize, or approve such major corporate actions.

While Sub 1's stock is subject to the Agreement, US Parent will be entitled to receive cash dividends declared thereon. Any stock dividends are to be accepted by the Proxy Holders and held in trust for US Parent. US Parent may also sell, transfer, or pledge all or any portion of its Sub 1 stock, provided that appropriate notice is given to

Agency. The Proxy Holders will have no power to sell or otherwise transfer, pledge, or encumber Sub 1's stock.

The Proxy Holders will be required to act in good faith as reasonably prudent business persons to protect US Parent's legitimate economic interests in Sub 1 as an ongoing business concern. Furthermore, while the ability of US Parent to communicate with the Proxy Holders will be restricted, US Parent will be permitted to make nonbinding suggestions or requests to the Proxy Holders at meetings with the Proxy Holders. The Proxy Holders may accept this advice if it is consistent with Sub 1's obligations and is otherwise consistent with Department's rules. Sub 1 will be allowed to provide US Parent with financial data relating to the financial condition and financial operations of Sub 1. Sub 1 will respond in writing to US Parent's questions concerning this financial information.

US Parent will be allowed to remove a Proxy Holder for gross negligence or willful misconduct. US Parent may also, with the approval of Department, remove a Proxy Holder for acts in violation of the Agreement. A successor Proxy Holder is to be nominated and appointed by the remaining Proxy Holders. US Parent will be permitted to veto, without cause, any successor Proxy Holder proposed by the remaining Proxy Holders. If US Parent vetoes three successive nominees, Agency will accept the third such nominee unless US Parent appeals to Agency for reasonable cause.

US Parent and Sub 1 will be allowed to petition Agency to terminate the Agreement at any time and for any reason. Department may refuse to terminate the Agreement only when continuation is necessary in the interest of national security. The Agreement will be subject to termination by Agency at any time under the following circumstances: (1) Sub 1 is sold to a person not under foreign ownership, control, or influence; (2) the Agreement is no longer needed to maintain Sub 1's facility security clearance; (3) the facility security clearance is no longer necessary; or (4) the Agreement has been breached or Department determines that termination is in the national interest. Unless renewed, the Agreement will terminate automatically ten years after the date of execution.

Section 1504(a) of the Code defines an affiliated group as one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation, but only if the common parent owns directly stock meeting the requirements of section 1504(a)(2) in at least one of the other includible corporations, and stock meeting the requirements of section 1504(a)(2) in each of the includible corporations (except the common parent) is owned directly by one or more of the other includible corporations.

Section 1504(a)(2) of the Code provides, generally, that the ownership of stock of any corporation meets the requirements of this paragraph if it (A) possesses at least 80 percent of the total voting power of the stock of such corporation and (B) has a value equal to at least 80 percent of the total value of the stock of such corporation.

In Rev. Rul. 84-79, 1984-1 C.B. 190, P transferred all of the stock of its wholly owned subsidiary, S, to a revocable voting trust in order to satisfy FAA regulations. The trust agreement provided that the trustee had all voting power in the S stock, but could not vote the S stock in favor of either a sale of substantially all of S's assets or a dissolution of S without P's approval. All dividends, except for stock dividends, were to be paid directly to P. The trustee could not dispose of the S stock without P's approval. Additionally, P could remove the trustee at any time without cause and could also amend or terminate the trust agreement at any time. The revenue ruling holds that P's dominion over the S stock is as complete as the dominion exercisable by one having both beneficial and legal ownership. Therefore, P directly owns the S stock while the S stock is in trust.

From the facts submitted it is clear that even while the stock of Sub 1 is subject to the Agreement, US Parent retains all the economic interests in Sub 1. US Parent remains entitled to all dividends declared on the Sub 1 stock, is entitled to the benefit of any appreciation of the stock, and may sell or otherwise transfer all or a portion of its shares of Sub 1 to a third party. Therefore, the only issue remaining concerning Sub 1's inclusion in the US Parent affiliated group involves US Parent's voting rights in Sub 1. In the present arrangement, US Parent has given up its actual voting rights in Sub 1 to the Proxy Holders pursuant to the Agreement. However, US Parent appointed all of the initial Proxy Holders.

Taking into account the above factors, along with the facts that: (1) the Sub 1 stock was made subject to the Agreement solely to satisfy Department's requirement that Sub 1 be effectively insulated from foreign ownership, control, or influence in order to maintain its security clearances; (2) the initial Proxy Holders were appointed by US Parent; (3) US Parent still retains voting rights on certain corporate actions, even if it cannot elect the members of the board of directors; and (4) US Parent can terminate the Agreement at any time unless the continuation of the Agreement is necessary in the interest of national security, it is held as follows:

- (1) During the period that Sub 1's stock is subject to the Agreement, US Parent's ownership of Sub 1 stock constitutes beneficial and therefore direct ownership for purposes of section 1504(a) of the Code.
- (2) Sub 1 and Sub 1's direct and indirect wholly owned domestic includible subsidiaries which meet the requirements of section 1504(a) will be members of the affiliated group (within the meaning of section 1504(a)(1)) of which US Parent is the common parent and will be permitted to join in the filing of a consolidated federal income tax return (within the meaning of sections 1501 and 1502 of the Code and the regulations thereunder) with the affiliated group of which US Parent is the common parent.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is given regarding US Parent's acquisition of the stock of Sub 2.

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

A copy of this letter must be attached to any income tax return to which it is relevant.

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

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

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Jeffrey B. Fienberg  
Assistant to the Branch Chief, Branch 2  
Office of the Associate Chief Counsel (Corporate)