

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date: **JUN 28 1999**

**LEGEND**

Company A =

Company B =

Country M =

Plan X =

Article Y =

Trust Z =

This responds to your representative's letter dated May 17, 1999, and prior correspondence, requesting rulings concerning the federal tax consequences of the transactions described below. On December 14, 1998, you received a ruling letter from OP:E:EP:P:1 applying § 404 of the Code to these same facts.

**FACTS**

Company A's parent corporation is Company B, a Country M corporation. Company A maintains Plan X, a qualified profit-sharing plan under § 401(a) with a qualified cash or deferred arrangement under § 401(k). In addition to the employees of Company A, the employees of a number of related employers participate in Plan X.

Plan X allows employee pre-tax and after-tax contributions of from 1 to 11

175

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percent of compensation. The employer matching contributions are 100 percent of participant contributions up to 2 percent of base salary, plus 50 percent of participant contributions from above 2 percent to 6 percent of base salary.

In addition to the above employer matching contributions, Article Y has been added to Plan X to provide for U.S. employees to receive contributions of shares (a Share Contribution) of Company B pursuant to a stock option plan similar to that provided to the employees of Company B. Company B's shares cannot be sold to the employees of its U.S. subsidiary because its shares are not registered in the U.S.. Instead, the shares are made available to U.S. employees as additional matching employer contributions pursuant to Article Y of Plan X. An eligible employee must have one year of service and commit to "save" (contribute to Plan X) at least 6 percent of base salary a year for five years. After five years of such "saving", the employee is entitled to a Share Contribution.

At the start of each employee's "savings period", Company B will issue stock options to Trust Z. At the end of the employee's "savings" period (if the five-year savings requirement has been met), the trustees of Trust Z will exercise the stock options to purchase Company B shares to the extent that the option price (85 percent of the market price at the beginning of the employee's savings period) is less than the current market price, by immediately selling a sufficient number of shares at fair market value to pay the option price, and then transferring the remaining shares to Plan X to be credited to the employee's account.

Company A is a fourth tier subsidiary of Company B. Company B's first, second, third and fourth tier subsidiaries are wholly owned. Company B, through Trust Z (a grantor trust that is not a separate entity from its owner for federal tax purposes), will distribute its stock to Plan X for the benefit of Company A employees pursuant to the agreement that creates Plan X. The agreement states that such contributions of Company B stock shall be fully vested at all times. Plan X will hold the Company B shares, along with other assets, for the benefit of Company A employees. Plan X will hold the Company B shares in a pooled fund and will issue "units" in the fund to the Company B employee accounts. The value of each unit of the fund will be maintained at or near the market price of a share of Company B stock. Dividends, sale proceeds and other amounts paid with respect to the Company B stock, held by Plan X, will be added to and will become a part of the fund.

### **LAW AND ANALYSIS**

Section 301.7701-4(a) of the Procedure and Administration Regulations states that the term "trust" refers to an arrangement created either by a will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting or

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conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts. Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for the beneficiaries who cannot share in the discharge of this responsibility.

In Rev. Rul. 92-105, 1992-2 C.B. 204, the Service held that an Illinois land trust was not a trust for federal income tax purposes, thus allowing the beneficiary's interest to be exchanged for another property interest without recognition of gain or loss under § 1031. Although the Illinois land trust vested legal and equitable title in the hands of the trustee, the grantor retained sole authority and responsibility for dealing with the corpus for all purposes other than the transfer of title. Thus, because the Trustee's only responsibility was to hold and transfer title at the direction of the grantor, a trust was not established under § 301.7701-4(a).

Here, Company B created Trust Z to acquire stock options from it, execute those options at its direction, and then transfer the purchased stock to Plan X to be credited to the employees accounts. Company B is only using the trust form because it cannot transfer its stock directly to the employees of Company A because of securities registration laws. Apart from the initial capital of 500 pounds to establish Trust Z, the only assets of Trust Z are options to purchase Company B stock granted by Company B. On the predetermined "Option Exercise Date," Trust Z will exercise the option to purchase a sufficient number of shares of Company B stock to satisfy Plan X's requirements plus sufficient shares to cover the exercise price of all the shares. All of the shares not sold to cover the exercise price will be transferred to Company A for immediate contribution to Plan X. Trust Z acts according to directions from Company B or as already provided in the Plan X documents based on information supplied by Company A. Under no circumstances could the Trustee sell the Company B stock on a discretionary basis. Further, it is in Company B's absolute discretion to direct the Trustee to sell, call in, or convert instruments, invest, vary or transpose investments; to direct the Trustee to accumulate income of Trust Z; and to determine the charitable organizations to receive the capital and income of Trust Z upon its expiration. Because the Trustee holds legal title to Trust Z's res only because of U.S. securities laws and exercises no discretion or judgment concerning Trust Z's res, Trust Z is not a trust as defined in § 301.7701-4(a) and, therefore, is not a trust for federal tax purposes. See also, Estate of O'Connor v. Commissioner, 69 T.C. 165, 176 (1977) (stating that the definition of trust in § 301.7701-4(a) contemplates more activity on the part of the trust than acting as a simple conduit. Although trustees took legal title to the property the trustee's activity failed to rise to the level of protection or conservation).

CONCLUSION

Based solely on the information and representations provided by the Taxpayer, we conclude that Trust Z is not classified as a trust for federal tax purposes. Additionally, we rule that neither Company B nor Company A will recognize gain or loss as a result of the transfer of Company B stock by Trust Z to Plan X. See Rev. Rul. 80-76, 1980-1 C.B. 15; Rev. Rul. 77-449, 1977-2 C.B. 110.

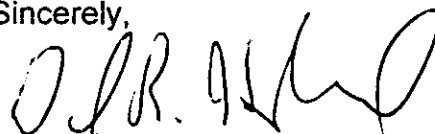
Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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.

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

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to Company A's authorized representative.

Sincerely,



David R. Haglund  
Senior Technician Reviewer, Branch 1  
Office of the Assistant Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)  
Copy of letter  
Copy for 6110 purposes