Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
April 23, 2001

Legend

Manager =

LLC =

LTD =

Plan =

X =

State 1 =

State 2 =

Country =

Month 1 =

Month 2 =

Dear

This letter responds to the request dated April 6, 2000, submitted on behalf of Manager, requesting rulings under the Procedure and Administration Regulations that Plan is a "business entity" eligible to be classified as a partnership for federal tax purposes and that Manager is eligible to serve as Plan's tax matters partner (TMP).

FACTS

Manager is a State 1 limited liability partnership and is the sole member of LLC, a State 2 limited liability company and a disregarded entity for federal tax purposes. LLC, in turn, is the sole shareholder of LTD, a corporation formed under the laws of Country. LLC and LTD are engaged in the investment banking business. Manager would like to enable employees of LLC and LTD to have the opportunity to participate in

similar investment activities. Manager proposes to institute Plan, an investment arrangement, under the laws of State 2 that will allow such participation.

Plan provides a highly structured environment through which Manager and employees that wish to participate will be able to share in the risks and rewards of investment activities. After receipt of their annual bonuses in Month 1, the employees will be permitted to make a contribution to Plan of after-tax dollars, not to exceed a certain percentage of their annual bonuses. Upon receipt of the bonuses, the employees that choose to participate will deliver a full recourse promissory note of the employee, bearing stated interest at the applicable federal rate (the preliminary commitment), which will be payable in full in Month 2 (the final commitment).

Over the course of the ensuing year, Manager will make investments in accordance with the Plan criteria. In addition to the amounts contributed by the participating employees, Manager will invest its own funds as well. The total investment will be an amount not less than X percent of the participating employees' investment. If, for some reason, the Plan investments are less than the preliminary commitments, the final commitments of the participating employees will be adjusted.

Manager will hold all of the investments in its own name. The participating employees will not have any legal ownership interest in such investments. However, through Plan, the participating employees will have contractual rights to a share of proceeds from the disposition of Plan investments that is proportionate to their share of the contributions. Plan will file a Form 1065 for each year it is in existence, and Schedules K-1 will be issued to Manager and all participating employees.

LAW AND ANALYSIS

Whether an organization is an entity separate from its owners for federal tax purposes is a matter of federal tax law and does not depend on whether the organization is recognized as an entity under local law. Section 301.7701-1(a)(1). A joint venture or other contractual arrangement may create a separate entity for federal tax purposes if the participants carry on a trade, business, financial operation, or venture and divide the profits therefrom. Section 301.7701-1(a)(2).

Section 301.7701-3(a) of the regulations provides that a "business entity" that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes as provided in this section.

Section 301.7701-3(a) further provides that an eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under § 301.7701-2(b)(2)) or a partnership, and an eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner. Section 301.7701-3(b) provides default classifications for eligible entities that do not make an election.

Section 301.7701-2(a) defines a "business entity," for purposes of this section and § 301.7701-3, as any entity recognized for federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under § 301.7701-3) that is not properly classified as a trust under § 301.7701-4 or otherwise subject to special treatment under the Code.

Section 301.7701-4(a) provides that, generally, an arrangement will be treated as a trust if the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Section 6231(a)(7) of the Internal Revenue Code provides that the tax matters partner (TMP) of any partnership is (A) the general partner designated as the TMP as provided in regulations, or (B) if there is no general partner who has been so designated, the general partner having the largest profits interest in the partnership at the close of the tax year involved (or, where there is more than one such partner, the one of such partners whose name would appear first in an alphabetical listing) (the “largest profits interest rule”). If there is no general partner designated and the Secretary determines that it is impracticable to apply the largest profits interest rule, the partner selected by the Secretary will be treated as the TMP.

A partnership may designate a partner as its TMP for a specific tax year as provided in § 301.6231(a)(7)-1(a). Section 301.6231(a)(7)-1(b)(1) provides that a person may be designated as the TMP of a partnership for a tax year only if that person (A) was a general partner in the partnership at some time during the tax year for which the designation is made, or (B) is a general partner in the partnership as of the time the designation is made. Section 301.6231(a)(7)-1(c) indicates that the partnership may designate a tax matters partner for a partnership taxable year on the partnership return for that taxable year in accordance with the instructions for that form.

CONCLUSIONS

Based solely on the facts submitted and representations made, we conclude that Plan is a "business entity" within the meaning § 301.7701-2(a). Because Plan is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7) or (8), we further conclude that Plan is an eligible entity that may be classified as a partnership for federal tax purposes as provided in § 301.7701-3(b). Furthermore, we conclude that Manager may be designated as Plan’s TMP in accordance with § 301.6231(a)(7)-1.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code.

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

Pursuant to the Power of Attorney on file with this office, this ruling is being sent to you and a copy of this ruling will be sent to Manager.

Sincerely,
Donna M. Young
Acting Branch Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2
Copy of letter
Copy for § 6110 purposes