Private Letter Ruling 9605015

November 8, 1995

**TEXT:**

This is in response to your letter dated August 25, 1995, requesting a ruling as to the federal income tax consequences of the transactions described below. Specifically, a ruling is requested regarding the application of *section 1504(a) of the Internal Revenue Code* ("Code"). Additional information was received in a letter dated September 11, 13 and October 5, 1995. The information submitted is summarized below.

Parent provides healthcare insurance to subscribers and is the common parent of an affiliated group of corporations which files a consolidated return for federal income tax purposes. Parent is in the process of developing an integrated health care delivery system designed to service Parent's subscribers throughout State X. As a part of this process, Parent has acquired three primary care medical practices using the following acquisition strategy.

A new professional corporation is formed to acquire the intangible assets of the targeted medical practice, employ the physicians selling their practice, and provide medical care to patients. The funds required for the acquisition are provided to the new professional corporation by either Parent or Acquiring, a wholly owned subsidiary of Parent. Legal title to the professional corporation's stock is owned by Employee in order to comply with State X's law that prohibits anyone other than a licensed physician from owning the stock of a professional corporation. As described below, such ownership is severely circumscribed. The tangible assets of the target medical practice are acquired by a management services organization which provides management and administrative services to the newly created, acquiring professional corporation.

Using this general format, Acquiring formed Corporation A and Corporation B (hereinafter sometimes referred individually as "PC" and collectively as the "PC's") to separately effect the purchase of two medical practices. All of the stock of each of Corporation A and Corporation B is held by Employee. Corporation AB, a wholly owned subsidiary of Acquiring, holds the tangible assets of each of the PC's and provides them with management and administrative services. This acquisition procedure has also been used to acquire a 50 percent interest in a third medical practice through PCC, a newly formed professional corporation, which is provided administrative and managerial services by Corporation C.

All of the funds used by Employee to acquire the stock of the PC's were loaned to him by Acquiring. The loans are evidenced by nonrecourse notes and secured by a pledge of the stock of each of the PC's to Acquiring. Acquiring also holds an open ended option allowing it to acquire at any time all of Employee's stock in the PC's.

The pledge agreements provide that Employee must give Acquiring 10 days notice prior to any exercise of his right to vote, must consult with Acquiring with regard to any vote, and must give 5 days notification to Acquiring of his intention with respect to the vote. In the event that Employee does not intend to comply with Acquiring's recommendation with regard to his exercise of the vote, Acquiring will exercise its option to purchase the stock of the affected PC through another licenced physician in its employ who will vote in accordance with Acquiring's desires. In the event that Employee misrepresents his intentions with regard to the vote, Acquiring will exercise its option to purchase immediately after the vote and demand a revote on the issue.

The pledge agreements further provide that Employee may not receive dividends from the PC's and if mistakenly received, provides for the contribution of the dividend to the distributing PC. To insure that Employee will not profit from any increase in value of a PC, the agreement provides that Acquiring may acquire the stock of the PC from Employee at any time pursuant to the option agreement for an amount equal to the amount paid by Employee for such stock. The nonrecourse nature of the note insures that Employee will not be liable in the event that the stock of a PC declines in value.

Acquiring controls the governance of the PC's through its selection of their officers and directors and Corporation AB controls their day to day operations through it authority and responsibility to provide management and administrative services. Corporation AB is ultimately responsible to Acquiring for the PC's operations.

Thus, under the facts and representations submitted, all of the risks associated with the businesses of the PC's runs to Acquiring and all of the economic value of these PC's accrues to the benefit of Acquiring.

The following representations were made by the taxpayer:

(a) Employee is not employed by or involved in the operations of the professional corporations.

(b) Acquiring would exercise its option to acquire the stock of the professional corporation if Employee intended to vote the shares, or otherwise act with respect to such shares in a manner which is unacceptable to Acquiring.

(c) Employee owns legal title to stock in the professional corporations possessing (a) at least 80 percent of the total voting power of the stock of such corporations and (b) a value equal to at least 80 percent of the total value of the stock of such corporations. There is only one class of stock in the professional corporations and there are no stock rights which could adversely affect the 80 percent threshold.

Based upon the facts submitted and the representations made, it is held as follows:

(1) During the period in which the stock of Corporation A and Corporation B is subject to the pledge agreement, securing a non-recourse loan and the option agreement, the ownership of the stock of the PC's by Employee will constitute beneficial ownership to Acquiring and therefore direct ownership for purposes of *§1504(a)*.

(2) Therefore, since Acquiring is considered to directly own stock possessing at least 80 percent of the total voting power and value of the stock of the PC's, these corporations will be members of the affiliated group in which Acquiring is also a member, and may join in the filing of a consolidated federal income tax return with such affiliated group of which Parent is the common parent. *Section 1504(a) of the Code* and §1.1502-75(a)(1) of the Income Tax Regulations.

No rulings were requested and none are provided regarding the status of Corporation AB, Corporation C, or PCC as members of the affiliated group.

No opinion is expressed about the tax treatment under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above rulings.

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

A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this letter is consummated.

Pursuant to the power of attorney on file a copy of this letter has been sent to your authorized representative.

Sincerely yours, Assistant Chief Counsel (Corporate), David P. Madden, Chief, Branch 5.