



United States Department of the Interior

BUREAU OF RECLAMATION
PO Box 25007
Denver, Colorado 80225-0007

IN REPLY REFER TO:

D-5300
LND-9.00

JUL 27 2004

Subject: Application of the Acreage Limitation Provisions to Entities, Part Owners, and Wholly Owned Subsidiaries

Dear Ladies and Gentlemen:

The purpose of this letter is to (1) provide district staff with additional information concerning the application of the acreage limitation provisions to legal entities, entities' part owners, and entities' wholly owned subsidiaries, and (2) specify the effects that entities, part owners, and wholly owned subsidiaries have on each other with respect to various aspects of Reclamation Reform Act of 1982 (RRA) application. The enclosure to this letter is divided into the following parts:

Part 1	Table format of explanatory information
Part 2	Examples

If the meaning of a term used in the enclosure is not clear to you, please consult the definitions provided in Form 7-21INFO, "General Information About the RRA Forms" and section 2 of the Acreage Limitation Rules and Regulations (Regulations; 43 CFR¹ part 426). The table and examples have been provided as a convenient way to obtain general answers to questions involving part owners. If you have any further questions concerning the effects that part owners and wholly owned subsidiaries may have on an entity's acreage limitation entitlements and vice versa, please contact the appropriate Reclamation office.

Sincerely,

/s/ KENNETH G. MAXEY

FOI

Roseann Gonzales, Director
Office of Program and Policy Services

Enclosure

¹ Code of Federal Regulations

Part I

Table

**RRA APPLICATION
ENTITIES, PART OWNERS, AND
WHOLLY OWNED SUBSIDIARIES**

RRA APPLICATION
ENTITIES, PART OWNERS, AND WHOLLY OWNED SUBSIDIARIES

CONCEPT	APPLICATION
Who is considered a part owner?	Natural persons that receive a direct benefit from an entity. For corporations, the shareholders named on stock certifications. For partnerships, the partners identified in the agreement. For tenancies, only the tenants named in the landownership documents. Generally, spouses and dependents are not counted unless specifically named.
How do you count natural persons where one entity is owned by another entity?	The number of all natural persons in all entities in the ownership structure that directly benefit will be counted to determine whether the entity is a qualified or limited recipient. <i>*See Example 1 on page 1 of the "Part 2 (Examples)" section that was distributed with this table.*</i>
What is the "most limiting factor?"	It is the effect a part owner may have on an entity's ability to realize its full entitlement. The part owner that most limits the entity will control the amount of the entity's entitlements that can be realized. It is determined by dividing each part owner's entitlement by the part owner's percentage of ownership interest in the entity. The part owner with the least entitlement will determine the entity's ability to realize its entitlement. <i>*See example 2 on page 1 of the "Part 2 (Examples)" section that was distributed with this table.*</i>
How can a part owner affect an entity's ownership entitlement?	The amount of an entity's ownership entitlement that the entity will be able to realize is the number of acres that will not result in any part owner exceeding his/her/its ownership entitlement after the entity's land is appropriately attributed to its part owners. Note: Refer to the "most limiting factor" explanation in the row above. <i>*See Example 3 (parts A and B) on page 2 of the "Part 2 (Examples)" section that was distributed with this table.*</i>
Does a part owner have to complete a Form 7-21XS, "Designation of Excess Land," if the entity exceeds its ownership entitlement (i.e., has excess land) and the part owner does not exceed his/her/its ownership entitlement?	A part owner only has to complete a Form 7-21XS if the part owner exceeds his/her/its ownership entitlement. However, if the part owner must submit that form and the entity has designated any of its land as excess for whatever reason, then the part owner must show on his/her/its own Form 7-21XS the portion of the entity's excess land that is attributed to the part owner through the part owner's interest in the entity.
What happens when a part owner exceeds his/her/its ownership entitlement and the entity does not exceed its ownership entitlement?	The part owner must complete a Form 7-21XS and designate directly owned land, or persuade an entity in which the part owner indirectly owns land to designate an appropriate amount of its land as excess, or a combination of both. If the part owner persuades an entity to designate some of its land as excess, the entity must do so by completing its own Form 7-21XS. <i>*See Example 4 on page 2 of the "Part 2 (Examples)" section that was distributed with this table.*</i>
Can a part owner designate land he/she/it owns through an entity as excess land?	No. A part owner may not under any circumstance designate indirectly owned land as excess without the permission of the direct landholder (by virtue of the direct landholder completing a Form 7-21XS).
How does an entity designate excess land for a part owner?	The entity can designate an amount of land as excess that will result in the needed number of acres designated as excess being attributed to the part owner.
What is the consequence of delivering Reclamation irrigation water to ineligible excess land?	Deliveries will be terminated. The compensation rate (full-cost) and administrative fees will be assessed.
Will the compensation (full-cost) and administrative fees be assessed retroactively in cases where either no land or an inadequate amount of land was designated as excess?	Yes.
How can a part owner affect an entity's nonfull-cost entitlement?	The amount of an entity's nonfull-cost entitlement that it will be able to realize is the number of acres that will not result in any part owner exceeding his/her/its nonfull-cost entitlement after the entity's land is appropriately attributed to its part owners.

CONCEPT	APPLICATION
Does a part owner have to complete a Form 7-21FC, "Selection of Full-Cost Land," if the entity exceeds its nonfull-cost entitlement (i.e., has full-cost land) and the part owner does not exceed his/her/its nonfull-cost entitlement?	A part owner only has to complete a Form 7-21FC if the part owner exceeds his/her/its nonfull-cost entitlement. However, if the part owner must submit that form and the entity has selected any of its land as full-cost for whatever reason, then the part owner must show on his/her/its own Form 7-21FC the portion of the entity's full-cost land that is attributed to the part owner through the part owner's interest in the entity.
What happens when a part owner exceeds his/her/its nonfull-cost entitlement and the entity does not exceed its nonfull-cost entitlement?	The part owner must complete a Form 7-21FC and select directly held land, or persuade an entity in which the part owner indirectly holds land to select an appropriate amount of its land as full-cost, or a combination of both. If the part owner persuades an entity to select some of its land as full-cost, the entity must do so by completing its own Form 7-21FC. <i>*See Example 6 on page 4 of the "Part 2 (Examples)" section that was distributed with this table.*</i>
Can a part owner select land he/she/it owns through an entity as full-cost land?	No. A part owner may not under any circumstance select indirectly held land as full-cost without the permission of the direct landholder (by virtue of the direct landholder completing a Form 7-21FC).
What is the consequence if Reclamation irrigation water is delivered at the wrong rate?	If part owners do not make a full-cost selection when required, all of their land will be ineligible for Reclamation irrigation water. Water will not be terminated during an irrigation season, but the land will be ineligible in future water years if a full-cost selection is not made.
Will full-cost charges and applicable underpayment interest be assessed retroactively for water that was delivered to land that is subsequently selected as full-cost land?	Yes.
What is an "intermediate entity?"	An entity that is a part owner of another entity and in turn is owned by others (either another entity or individuals).
Do intermediate entities have to submit RRA forms?	Yes.
What is a "wholly owned subsidiary?"	An entity that is 100-percent owned by another entity.
Who is attributed with the land held by a wholly owned subsidiary?	The parent entity.
How do wholly owned subsidiaries affect an entity's nonfull-cost entitlement?	Since all of the land held by a wholly owned subsidiary is attributed to the parent entity, the acreage limitation entitlements and westwide landholdings of the parent entity will determine how much land held by the wholly owned subsidiary is eligible to receive Reclamation irrigation water and the rate to be paid. <i>*See Example 5 (parts A and B) on page 3 of the "Part 2 (Examples)" section that was distributed with this table.*</i>
Do wholly owned subsidiaries have to submit RRA forms?	No. The parent entity must identify on its form all land held by any wholly owned subsidiaries.
Will a prior law parent entity's irrevocable election to conform to the discretionary provisions affect the acreage limitation status of its wholly owned subsidiary, and vice versa?	No. A parent entity's irrevocable election has no effect upon its wholly owned subsidiary, and a wholly owned subsidiary's irrevocable election has no effect on its parent entity. Therefore, if both the parent entity and the wholly owned subsidiary are subject to the prior law provisions, the parent entity and the wholly owned subsidiary must make separate irrevocable elections to conform to the discretionary provisions.

NOTE: This information is not all inclusive. If you have any questions, contact the appropriate Reclamation office.

Part 2

Examples

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The following examples illustrate selected concepts detailed in Part 1 (Table) and are numbered to correspond to the examples referenced in Part 1.

Counting Natural Persons

Example 1 - In determining if an entity is a limited recipient or a qualified recipient, how are natural persons determined to be part owners?

Assume an entity (that is subject to the discretionary provisions) is owned equally by 26 adults, two of which are married to each other. The entity benefits 26 natural persons, therefore it is considered to be a limited recipient, even though only 25 "individuals" as defined by the RRA exist (under the discretionary provisions, a married couple counts as one "individual" unless the husband and wife are each listed as separate part owners). For purposes of determining whether entities are limited or qualified recipients, the number of "natural persons" not "individuals" is counted.

Application of the "Most Limiting Factor" Concept

Example 2 - What is the "most limiting factor" concept?

Assume an entity that is a limited recipient with a 320-acre nonfull-cost entitlement is owned equally by four part owners, all of whom hold no land subject to acreage limitations outside of this entity. Part Owner A, a qualified recipient, has a 960-acre nonfull-cost entitlement; Part Owner B, a prior law recipient, has a 160-acre nonfull-cost entitlement; Part Owner C, a limited recipient, has a 320-acre nonfull-cost entitlement; and Part Owner D, another limited recipient, has a zero acre nonfull-cost entitlement. In this case, Part Owner D most limits the entity and, thus, controls how much of the entity's entitlement can be realized. Specifically, the entity cannot realize any of its 320-acre nonfull-cost entitlement. If the entity holds 320 acres, then all of it must be selected as full-cost land. To provide otherwise would result in Part Owner D receiving benefits to which it is not entitled. See the following table.

Part owner	Part owner's nonfull-cost entitlement	Percent owned by part owner	Part owner's entitlement <i>DIVIDED BY</i> PERCENT OWNED of the entity or 960 acres, WHICHEVER IS LESS
Part Owner A	960 acres	25	960 acres (960÷25% = 3,840)
Part Owner B	160 acres	25	640 acres (160÷25% = 640)
Part Owner C	320 acres	25	960 acres (320÷25% = 1,280)
Part Owner D	0 acres	25	0 acres ← <i>most limiting factor</i> (0÷25% = 0)

Part Owners' Effect on an Entity's Ownership Entitlement

Example 3A - How can an entity's ownership entitlement be affected when one of the entity's part owners has the same ownership entitlement as the entity?

Assume Partnership A has an ownership entitlement of 960 acres. Sally, also a qualified recipient, owns 50 percent of Partnership A but also receives Reclamation irrigation water on 920 acres of land she owns directly. If Partnership A were to receive Reclamation irrigation water on 960 acres, Sally would be receiving the benefit of Reclamation irrigation water delivered to 480 acres through Partnership A ($960 \times 50\% = 480$). Therefore, Sally would realize the benefit of receiving Reclamation irrigation water on a total of 1,400 owned acres ($920 + 480 = 1,400$). However, she is limited to receiving Reclamation irrigation water on only 960 owned acres. Steps will have to be taken to bring the parties into compliance, such as the entity and/or Sally designating excess land.

Example 3B - How can an entity's ownership entitlement be affected when one of the entity's part owners has a smaller ownership entitlement than the entity?

Assume Corporation C, which owns 960 acres, is a qualified recipient and, therefore, has an ownership entitlement of 960 acres. Jeff owns 40 percent of Corporation C and is a prior law recipient with an entitlement of 160 acres. Therefore, the amount of Corporation C's acreage that is attributed to Jeff is 384 acres ($960 \times 40\% = 384$). This exceeds Jeff's ownership entitlement of 160 acres. Assuming Jeff holds no other land, Corporation C can only receive Reclamation irrigation water on 400 acres of its owned land ($160 \div 40\% = 400$). This would result in 160 acres of owned, nonexcess land being attributed to Jeff ($400 \times 40\% = 160$). The entity's ability to fully realize its ownership entitlement was limited even without the part owner owning any land directly or indirectly through another entity.

How Part Owners Can Affect the Designation of Excess Land, and Related Issues

Example 4 - What happens if a part owner exceeds his/her/its ownership entitlement and must complete a Form 7-21XS to designate excess land?

Assume Ellen, a qualified recipient, indirectly owns 720 acres through an 80-percent ownership of Corporation C, and 630 acres through a 70-percent ownership of Corporation D. She therefore owns 1,350 acres indirectly ($630 + 720 = 1,350$), which exceeds her 960-acre ownership entitlement by 390 acres. An amount of land from one or both corporations must be declared as excess so that the number of acres attributed to Ellen results in her receiving Reclamation irrigation water on only 960 acres of directly and/or indirectly owned land. Both entities are ineligible to receive any Reclamation irrigation water until this is done. One of many possible scenarios that would bring Ellen and both corporations into compliance is if Corporation C declared 225 acres as excess and Corporation D declared 300 acres as excess, as shown in the following table.

Party	Number of acres owned		Acres designated excess by the entities		Acres designated nonexcess by the entities	
	Directly	Attributed to Ellen	Directly	Attributed to Ellen	Directly	Attributed to Ellen
Corporation C	900	720 (80%)	225	180 (80%)	675	540 (80%)
Corporation D	900	630 (70%)	300	210 (70%)	600	420 (70%)
Ellen's total	N/A	1350	N/A	390	N/A	960

Entity's Effect on Its Wholly Owned Subsidiaries' Nonfull-Cost Entitlement

Example 5A – How can a wholly owned subsidiary's nonfull-cost entitlement be affected by its parent entity under the discretionary provisions?

The David Corporation leases 960 acres in District Z, which remains subject to prior law. In order to receive Reclamation irrigation water on its entire landholding, the David Corporation, which only has 3 part owners, conformed to the discretionary provisions in 1992. In 1997, the Goliath Partnership buys the David Corporation, but rather than disbanding that company, the Goliath Partnership keeps it as a wholly owned subsidiary. The Goliath Partnership also decides to remain subject to the prior law provisions, which it can do because it holds no land directly in any discretionary provisions district and it has never taken action to conform to the discretionary provisions. As a prior law partnership that does not provide for separable and alienable interest to its part owners, the Goliath Partnership has a prior law nonfull-cost entitlement of 160 acres. Accordingly, the David Corporation cannot realize its entire 960-acre nonfull-cost entitlement. As the parent entity, the Goliath Partnership would be required to submit RRA forms and include on those forms all lands held in the name of the David Corporation. In doing so, the Goliath Partnership must select 800 acres as full-cost land since Reclamation treats the parent of a wholly owned subsidiary as the direct holder of the land for such purposes.

Example 5B – How is an entity's nonfull-cost entitlement determined when wholly owned subsidiaries are involved?

If a wholly owned subsidiary did not receive Reclamation irrigation water on or before October 1, 1981, and the parent entity did, the subsidiary is entitled to receive nonfull-cost Reclamation irrigation water up to the parent's nonfull-cost entitlement (assuming the parent entity holds land only through that subsidiary). If a parent entity is a limited recipient and it did not receive Reclamation irrigation water on or before October 1, 1981, neither the parent entity nor the wholly owned subsidiary can receive any nonfull-cost water, regardless of when the wholly owned subsidiary may have first received Reclamation irrigation water.

How Part Owners Can Affect the Selection of Full-Cost Land, and Related Issues

Example 6 - What happens if a part owner exceeds his/her/its nonfull-cost entitlement and must complete a Form 7-21FC to select full-cost land?

Company A is a limited recipient with a nonfull-cost entitlement of 320 acres and leases 320 acres directly. Susan is a qualified recipient with a nonfull-cost entitlement of 960 acres. She owns 60 percent of Company A and holds no other land. Andy is a qualified recipient with a nonfull-cost entitlement of 960 acres and he owns 20 percent of Company A. Accordingly, 60 percent of Company A's acreage is attributed to Susan, which means 192 acres will be attributed against her nonfull-cost entitlement of 960 acres. Twenty percent of Company A's nonfull-cost acreage is attributed to Andy, which is 64 acres. The other 20 percent of Company A is held equally by 25 natural persons (.8 percent [2.56 acres] each) who are all qualified recipients that hold no other land. However, Andy also leases 960 acres directly. Therefore, he holds a total of 1,024 acres. For Andy to be within his nonfull-cost entitlement, he must either select at least 64 acres of his directly held land as full-cost land or convince Company A to select all of its land as full-cost, thereby attributing no acreage to count against Andy's nonfull-cost entitlement. Another possibility would be a combination of reductions by both Company A and Andy as shown in the following table.

Party	Nonfull-cost entitlement	Acres held directly	Percentage (and acres) of Company A's nonfull-cost entitlement attributed to party	Acres declared nonfull-cost	Acres declared full-cost
Company A	320 acres	320	100% (320 acres)	200	120
Susan	960 acres	0	60% (192 acres)	120	72*
Andy	960 acres	960	20% (64 acres)	920 directly held, 40 indirectly held	40 directly held 24 indirectly held
Other part owners (25 natural persons)	960 acres for each of the 25 natural persons	0	.8% (2.56 acres) for each of the 25 natural persons	1.60 by each of the 25 natural persons	.96 by each of the 25 natural persons

* Because Susan's landholding does not exceed her nonfull-cost entitlement, she is not required to submit a Form 7-21FC, although the land attributed to her from Company A as full-cost land is charged the full-cost rate.