TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Legend:

Company A =

Company B =

Company C =

Plan M =

Plan N =

This is in response to a request for a private letter ruling dated June 8, 2001, as revised by letters of January 9 and 23, 2002, and February 28, 2002 submitted on your behalf by your authorized representative. The request concerns Plan M, which includes a leveraged employee stock ownership plan and the tax consequences of the spin-off of a subsidiary by the parent corporation sponsoring Plan M.

Company A maintains Plan M for its employees and employees of participating employers including Company B which is at least ercent owned by Company A. Plan M, as originally established effective and as subsequently amended, is a tax-qualified defined contribution plan under section 401(a) of the Code, that includes a cash or deferred arrangement under section 401(k) of the Code. In Plan M was amended to add a leveraged employee stock ownership plan portion ("LESOP") pursuant to section 4975(e)(7) of the Code. Plan M's most recent favorable determination letter is dated April 2, 2001. Effective January 1, 2001, Company B and certain of its United States subsidiaries (including Company C), which had not previously adopted Plan M, adopted Plan M. During Plan M purchased approximately

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shares of Company A's common stock (the ESOP Shares) with the proceeds of a loan from Company A (the Exempt Loan). The ESOP shares are held in a suspense account (the LESOP suspense account) until their release and allocation to participants' accounts as the Exempt Loan is repaid with cash dividends paid on the ESOP Shares remaining in Plan M and with employer contributions

Through a series of preliminary asset and stock transfers, Company A will contribute certain of its existing businesses to Company B. Company B completed an initial public offering of less than percent of its outstanding common stock (IPO) on . It is currently anticipated that within twelve months following the IPO, the remaining shares of Company B stock will be distributed to Company A's shareholders or Company A's newly formed holding company's shareholders in a tax-free spin-off intended to qualify under section 355 of the Code. Pursuant to the spin-off, each shareholder of Company A stock, including Plan M, will receive shares of Company B shares in accordance with a distribution ratio to be determined based upon the market values of Company A common stock and Company B common stock on the date of the spin-off. Following the spin-off, Company A and Company B will no longer be part of the same controlled group of corporations within the meaning of Code section 414(b), (c), (m), or (o) or for purposes of section 409(l)(4).

You have represented that the Company B common stock received by the LESOP suspense account of Plan M pursuant to the spin-off will be reinvested by the trustee in Company A common stock not later than the 90th day following the spin-off.

Generally, Plan M participants who are employed in Company A's businesses that are being contributed to Company B have been or will be transferred to Company B in connection with the restructuring and the spin-off.

Also effective as of the date of the spin-off, Company A will amend Plan M to provide that Company B and its subsidiaries (including Company C) (the "company B Group) that adopted Plan M will cease to be participating employers under Plan M. Company B will establish Plan N, for its employees. Plan N will provide for contributions similar to those provided under Plan M. It is intended that Plan N will be qualified under section 401(a) and include a cash or deferred arrangement under section 401(k) of the Code. Plan N is not expected to contain an employee stock ownership plan under section 4975(e)(7) of the Code. The Plan M accounts of the employees of the Company B Group will be transferred from Plan M to Plan N in a direct trustee to trustee transfer of assets that you represent is in accordance with the requirements of section 414(l) of the Code

Based on the foregoing facts and representations, your authorized representative has requested the following rulings.

(1) Ruling request (1) has been withdrawn.

(2) The shares of Company B acquired by Plan M as a result of the spin-off will be treated as securities of the employer corporation for purposes of excluding net unrealized appreciation from income under section 402(e)(4) of the Code and Revenue Ruling 73-29.

(3) For purposes of determining net unrealized appreciation under section 402(e)(4) of the Code, the basis of the shares of Company A and shares of Company B held by Plan M will be determined by allocating the basis in the shares of Company M immediately before the spin-off

between the shares of Company A and the shares of Company B held immediately after the spin-off in accordance with section 358 of the Code.

(4) To the extent that Plan M disposes of the shares of Company B held by the LESOP suspense account and reinvests the proceeds in shares of Company A within ninety days of such disposition, the basis of the replacement shares of Company A for purposes of determining net unrealized appreciation under section 402(e)(4) of the Code will be equal to the basis of shares of Company B determined in the manner described in ruling request three above.

(5) Ruling request (5) has been withdrawn.

(6) For any period of time in which the LESOP Suspense Account holds shares of both Company A and Company B, the number of shares of Company B held in suspense will be taken into consideration when calculating the number of shares to be released from suspense under section 4975 of the Code, and may then be converted to an equivalent number of shares of Company A for release from suspense based on the fair market value of the shares of Company B and shares of Company A at the time of release.

(7) To the extent that Plan M disposes of the shares of Company B received with respect to the unallocated ESOP shares of Company A and reinvests the proceeds in shares of Company A within a reasonable time after the spin-off, such shares of Company A will be deemed to have been acquired with the proceeds of the Exempt Loan. Accordingly, dividends paid on such shares of Company A will be deductible by Company A under section 404(k) of the Code if the dividends are used to repay the exempt Loan to the same extent that such dividends were deductible by Company A with respect to the original ESOP Shares.

(8) That the 90-day reinvestment period described in section 1.46-8(e)(10) of the Income Tax regulations will constitute a reasonable period for the reinvestment described in ruling request number seven.

(9) Shares of Company B and Company A transferred from Plan M to Plan N will be securities of the employer corporation for purposes of excluding net unrealized appreciation from income under section 402(e)(4) of the Code when subsequently distributed to a participant in Plan N as part of a lump sum distribution.

(10) For purposes of determining net unrealized appreciation under section 402(e)(4) of the Code applicable to Company B shares described in ruling request nine, the basis of the shares of Company A and Company B transferred from Plan M to Plan N will be the same as the basis of the shares in Plan M before the transfer (determined as described in ruling request three).

With respect to ruling request two, section 402(e)(4)(B) of the Code provides that in the case of a lump sum distribution which includes securities of the employer corporation, unless a taxpayer elects otherwise, there shall not be included in gross income the net unrealized appreciation attributable to that part of the distribution which consists of securities of the employer corporation. Under section 1.402(a)-1(b)(2) of the Income Tax regulations, the amount of net unrealized appreciation in securities of the employer corporation which are distributed by the trust is the excess of the market value of such securities at the time of distribution over the cost or other basis of such securities to the trust. Section 402(e)(4)(E) of the Code provides generally that the term "securities of the employer corporation" includes securities of a parent or subsidiary corporation (as defined in section 424(e) and (f)) of the employer corporation.

In Revenue Ruling 73-29, 1973-1 C.B. 198, securities of an employer corporation held by its qualified plan were transferred to the qualified trust of an unrelated corporation when the first employer sold part of its business and transferred some of its employees to the buyer corporation. The ruling concluded that shares of stock of the seller corporation distributed from the buyer's qualified trust to employees of the buyer corporation who are former employees of the seller corporation are securities of the employer corporation for purposes of excluding net unrealized appreciation from the distributee's gross income. Revenue Ruling 73-29 further holds that once shares are held to be securities of the employer corporation, they continue to be held as securities of the employer corporation even after those shares and the employees in whose account they were held were transferred to an unrelated corporation.

In this case it is represented that Company B was an eighty percent or more owned subsidiary of Company A prior to the spin-off. Therefore the stock of Company B constituted securities of Company A before the spin-off and their allocation to participant's accounts represents interests previously allocated to the accounts as Company A stock prior to the spin-off. Accordingly, we conclude with respect to ruling request two that, the shares of Company B acquired by Plan M as a result of the spin-off will be treated as securities of the employer corporation for purposes of excluding net unrealized appreciation from income under section 402(e)(4) of the Code and Revenue Ruling 73-29.

With respect to ruling request three, section 1.358-2(a)(2) of the regulations provides that if, as a result of a transaction under section 355, a shareholder who owned stock of only one class before the transaction owns stock of two or more classes after the transaction, then the basis of all the stock held before the transaction is allocated among the stock of all classes held immediately after the transaction in proportion to the fair market values of the stock of each class. Accordingly, in response to ruling request three, it is concluded that for purposes of determining net unrealized appreciation under section 402(e)(4) of the Code, the basis of Company A shares and Company B shares held by Plan M immediately after the spin-off is the same as the basis of the Company A shares held immediately before the spin-off, allocated in proportion to the fair market value of Company A and Company B shares on the date of the spin-off.

With respect to ruling request four, section 402(j) provides, in pertinent part, that for purposes of section 402(e)(4), in the case of any transaction in which either (I) the plan trustee exchanges the plan's securities of the employer corporation for other such securities, or (ii) the plan trustee disposes of the plan's securities of the employer corporation and uses the proceeds of such disposition to acquire other securities of the employer corporation within 90 days (or such longer period as the Secretary may prescribe) the determination of net unrealized appreciation shall be made without regard to such transaction.

In the present case, in accordance with ruling two above, for purposes of section 402, shares of Company B are securities of the employer corporation and the ninety day period for reinvestment under section 402(j)(2)(B) will commence upon the actual sale, exchange or other disposition of the Company B shares and not upon the date of the spin-off. Accordingly, in ruling request four it is concluded that to the extent that the Plan M trustee disposes of the shares of Company B held by the LESOP suspense account and reinvests the proceeds in shares of Company A within ninety days of such disposition, the basis of the replacement shares of Company A for purposes of determining net unrealized appreciation under section 402(e)(4) of the Code will be equal to the basis of shares of Company B determined in the manner described in ruling request three above.

With respect to the sixth ruling request, section 54.4975-7(b)(8) of the Excise Tax Regulations provides, generally, that an exempt loan in an ESOP must provide for the release from encumbrance of plan assets used as collateral for the loan. Section 54.4975-7(b)(8) further provides that for each plan year during the duration of the exempt loan, the number of securities released must equal the number of encumbered securities held immediately before release for the current plan year multiplied by a fraction, the numerator of which is the amount of principal and interest paid for the year and the denominator of which is the sum of the numerator plus the principal and interest to be paid for all future years. Finally, section 54.4975-7(b)(8) provides that if collateral for the loan includes more than one class of securities, the number of securities of each class to be released for a plan year must be determined by applying the same fraction to each class.

Section 54.4975-11(c) of the Excise Tax Regulations provides that all assets acquired with the proceeds of an exempt loan under section 4975(d)(3) of the Code must be held in the suspense account and withdrawn from the suspense account by applying section 54.4975-7(b)(8) as if all securities in the suspense account were encumbered.

In this case Company B shares acquired by Plan M in the spin-off were acquired solely because Plan M held Company A stock which was acquired with the proceeds of an exempt loan. Thus, for purposes of section 54.4975-11(c) of the regulations such Company B shares in Plan M as a result of the spin-off will be treated as if they were also acquired with the exempt loan proceeds. As a result, such Company B shares in Plan M must be held in the Plan M suspense account and withdrawn as if encumbered. Further such Company B shares must be taken into account in determining the number of Company A shares to be released from the Plan M suspense account in accordance with section 54.4975-7(b)(8) of the regulations.

Applying section 54.4975-7(b)(8) of the regulations to this case requires that Company B shares in Plan M also be treated as a separate class of securities. However, in lieu of releasing Company B shares from the Plan M suspense account, an equivalent number of Company A shares may be released determined by converting the number of Company B shares that should have been released into such equivalent number of Company A shares of stock based on the fair market value of the Company A and Company B shares. Accordingly, in ruling request six it is concluded that for any period of time in which the LESOP Suspense Account holds shares of both Company A and Company B, the number of shares of Company B held in suspense will be taken into consideration when calculating the number of shares to be released from suspense under section 4975 of the Code, and may then be converted to an equivalent number of shares of Company A for release from suspense based on the fair market value of the shares of Company B and shares of Company A at the time of release.

With respect to your seventh ruling request, section 404(k) of the Code generally permits a corporation to deduct the amount of any applicable dividend paid in cash by the corporation during the taxable year with respect to employer securities which are held on the record date for such dividend by an ESOP which is maintained by the corporation paying the dividend or any other member of the same controlled group. Section 404(k)(2)(A)(iv) defines the term applicable dividend to include any dividend which, in accordance with plan provisions, is used to make payments on an exempt loan the proceeds of which were used to acquire the employer securities (whether or not allocated to participants) with respect to which the dividend is paid. Section 404(k)(2)(B) provides that a dividend described in section 404(k)(2)(A)(iv), paid with respect to employer securities allocated to a participant, is an applicable dividend only if the plan provides that employer securities with a fair market value of at least the amount of the dividend are allocated to the participant.

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Section 404(k)(6)(A) provides that the tem employer securities has the same meaning given such term by section 409(l). Under section 409(l), the term employer securities generally means common stock issued by the employer (or by a corporation which is a member of the same controlled group) which is readily tradable on an established securities market.

In this case, the Company B shares were acquired by Plan M pursuant to a spin-off as the direct result of Plan M's ownership of the original Company A stock which was acquired with the proceeds of the exempt loan. The Company B shares held by Plan M after the spin-off will represent part of the value of the original Company A shares held prior to the spin-off and acquired with the proceeds of the exempt loan. Since the Company B shares represent part of the assets acquired with the proceeds of the exempt loan, if Plan M disposes of the Company B shares and reinvest the proceeds in Company A shares within a reasonable period of time, we believe that the replacement Company A shares should be treated as assets acquired with the proceeds of the exempt loan. Consequently, in ruling request seven, it is concluded that to the extent that Plan M disposes of the shares of Company B received with respect to the unallocated ESOP shares of Company A and reinvests the proceeds in shares of Company A within a reasonable time after the spin-off, such shares of Company A will be deemed to have been acquired with the proceeds of the Exempt Loan. Accordingly, dividends paid on such shares of Company A will be deductible by Company A under section 404(k) of the Code if the dividends are used to repay the exempt Loan to the same extent that such dividends were deductible by Company A with respect to the original ESOP shares.

With respect to your eighth ruling request, we believe that the 90-day period sanctioned in section 1.46-8(e)(10) of the regulations is a reasonable period for the reinvestment described in ruling seven.

With regard to ruling request nine, the transfer of Company A and Company B shares in the Plan M accounts of Company B employees to Plan N is analogous to the situation described in Rev. Rul. 73-29. Accordingly, we conclude with regard to ruling request nine that the shares of Company B and Company A transferred from Plan M to Plan N, as described above, will be securities of the employer corporation for purposes of excluding net unrealized appreciation from income under section 402(e)(4) of the Code when subsequently distributed to a participant in Plan N as part of a lump sum distribution.

With respect to ruling request ten, it is represented that the transfer of assets from Plan M to Plan N meets the requirements of section 414(l) of the Code. In Revenue Ruling 80-138, the transfer of employer securities from a qualified plan maintained by a parent to a qualified plan maintained by a subsidiary did not change the basis in the securities for purposes of computing net unrealized appreciation, because the transfer, in which no amounts were distributed or made available to the subsidiary's employees, was not a taxable event. In the present case, the transfer of shares of Company B and Company A from Plan M to Plan N is similar to the transfer of employer securities in Revenue Ruling 80-138 because no amounts are being distributed to participants. Since there is no taxable event the basis in the securities transferred remains unchanged. Accordingly, in ruling request ten it is concluded that for purposes of determining net unrealized appreciation under section 402(e)(4) of the Code applicable to Company B shares described in ruling request nine, the basis of the shares of Company A and Company B transferred from Plan M to Plan N will be the same as the basis of the shares in Plan M before the transfer (determined as described in ruling request three).

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

The original of this ruling is being sent to your authorized representative in accordance with a power of attorney on file in this office.

The author of this ruling is who may be reached at .

Sincerely yours,

Frances V. Sloan

Frances V. Sloan, Manager
Employee Plans Technical Group 3
Tax Exempt and Government
Entities Division

Enclosures:
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Form 437