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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

JAN 12 2005

Uniform Issue List: 4975.00-00

SE:T:EP:RA:T3

Attention:

Legend:

Company A =

Company B =

Company C =

Company D =

Trustee E =

Plan X =

Dear

This is in response to your request for a private letter ruling, submitted by your authorized representative by letter dated November 5, 2003, concerning the federal income tax consequences of the repayment of an exempt loan under section 4975, 415, and 401(a)(4) of the Internal Revenue Code (the "Code"). Correspondence dated December 2, 2003, December 18, 2003, February 10, 2004, April 22, 2004, and June 9, 2004, supplemented the request.

Your authorized representative has submitted the following facts and representations:

Company A sponsors Plan X. Plan X is qualified under section 401(a) of the Code and consists of (i) an Employee Stock Ownership Plan ("ESOP") as described in section 4975(e)(7) of the Code, and (ii) a profit sharing plan, which includes a qualified cash or deferred arrangement as described in section 401(k).

Company A is a wholly-owned subsidiary of Company B. Trustee E is the independent, discretionary trustee of the trust established pursuant to the ESOP portion of Plan X (the "Trust").

On [redacted] Trustee E, in its capacity as trustee of the Trust purchased [redacted] shares of Company B's Class A common voting stock (the "Shares"), constituting approximately [redacted] percent of the outstanding common stock of Company B for $[redacted] (the "Purchase Price" and such purchase of Shares being the "Original Transaction").

The Trust borrowed from Company B an amount equal to the Purchase Price pursuant to a Term Loan and Security Agreement dated [redacted] (the "Loan"). Company B borrowed a portion of the funds from an independent third-party lender. You represent that the Trust used the Loan proceeds solely to purchase, directly from shareholders of Company B, the Shares primarily for the benefit of Plan X participants and their beneficiaries. The Loan was secured by a pledge of the Shares, subject to release of the Shares from such security as the Loan was paid in accordance with the release provision in Plan X and section 54.4975-7(b) of the Income Tax Regulations (the "regulations") and section 2250.408b-3 of the Department of Labor Regulations (the "DOL regulations") . You also represent that the Loan constitutes an exempt loan within the meaning of section 4975(d)(3) of the Code, section 408(b)(3) of ERISA, section 54.4975-7(b) of the regulations and section 255.408b-3 of the DOL regulations.

At the time the loan was entered into, Company A contemplated that Plan X would continue at least until the loan was repaid over the amortization period and all shares in the suspense account were allocated to the participants. Each month since the Original Transaction, Company A has contributed sufficient funds to Plan X to enable it to make all payments on the loan on a timely basis.

Approximately [redacted] years after the Original Transaction, Company B received an unsolicited inquiry from Company C, an unrelated, publicly-traded corporation, regarding the purchase of all of the issued and outstanding stock of Company B. Subsequently, certain shareholders of Company B, including Trustee E, on behalf of Plan X, entered into negotiations with Company C and Company D, a wholly-owned subsidiary of Company C.

On or about [redacted] substantially all of the shareholders of Company B, including Trustee E, entered into a Stock Purchase Agreement (the "Agreement") with Company C and Company D, under which Company D will acquire all of the issued and outstanding stock of Company B for cash. The purchase price will be an amount sufficient for Trustee E to repay the Loan in full. A merger of Company B with and into Company D will follow the purchase. The stock purchase, considered together with the subsequent merger as a single integrated transaction (the "Transaction"), is intended to qualify for federal income tax purposes as a tax-free reorganization under the provisions of section 368(a)(1)(A) of the Code

The value of the Shares held by Plan X for purposes of the proposed transaction, subject to certain adjustments specified in the Agreement, is expected to represent an increase of approximately [redacted] percent over the purchase price of the Shares in [redacted] and an increase of approximately [redacted] percent over the value of the Shares, as determined by the fiduciaries of Plan X on [redacted]

The Transaction is subject to an escrow arrangement relating to certain post-closing indemnity obligations of the shareholders of Company B.

Trustee E has agreed that, at closing, the Trust will repay the Loan in full. Following payment of the Loan, the remaining proceeds of the Transaction with respect to the unallocated shares ("Excess Sale Proceeds") will be allocated to participants' accounts under Plan X.

The Excess Sale Proceeds realized by the Trust in the Transaction will consist of both (i) the amounts to be held in escrow under an escrow agreement to which Trustee E is a party (which will be allocated later when the escrow terminates), and (ii) amounts to be allocated to individual accounts under Plan X, effective as of the closing date of the Transaction ("Closing Date"), in accordance with Subsection 6.3(e) of Plan X, as amended.

Amounts held in the escrow agreement, when released from escrow, if any, will be allocated in the same manner to the accounts of the same individuals who are eligible to receive an allocation of the original allocation of Excess Sale Proceeds at the Closing Date. The ESOP portion of Plan X will be terminated after the escrowed amounts are released from escrow and allocated to participants' accounts.

The total amount in the escrow under the escrow agreement is $[redacted] The portion of the Escrow Funds attributable to the ESOP is $[redacted] The Escrow Agreement provides in section 3(g) that if no claim is made against the Escrow Fund by Company D, the ESOP's share of the Escrow Funds will be distributed to the ESOP Trustee on the fifth anniversary of the closing date. The length of the Escrow Agreement was negotiated by Company C and the selling shareholders, one of which was Trustee E. In connection with its review of the terms of the sale, Trustee F obtained the advice of its independent financial advisor, which issued an opinion to the effect that the transaction, including the escrow agreement, was fair to Plan X and its participants. The resulting dollar amount and the five-year term of the Escrow Agreement were based primarily on two large class action lawsuits that are pending against Company A, the results of which cannot be predicted.

Based on the foregoing, you have requested the following rulings:

1. The use of the cash proceeds of the sale of the Shares held by Plan X to repay Plan X's indebtedness does not cause the Loan to fail to satisfy the requirements for exemption under section 4975(d)(3) of the Code.

2. Any allocation of Excess Sale Proceeds made to the accounts of the participants of Plan X as a result of the Transaction will not constitute annual additions to participants' accounts for purposes of Section 415 of the Code when allocated to the participants' accounts.

An ESOP is an arrangement designed to invest primarily in employer securities. An ESOP must be part of a stock bonus plan qualified under section 401(a) of the Code, or a stock bonus plan and a money purchase plan qualified under section 401(a). A leveraged ESOP borrows funds which it uses to purchase employer securities, usually from the employer. The ESOP loan is generally guaranteed by the employer. The acquired employer securities are held in a suspense account pending allocation to the accounts of plan participants in accordance with the rules of section 54.4975-11(d) of the

regulations. The ESOP generally uses employer contributions to the plan to repay the exempt loan.

Under section 4975(d)(3)(A) of the Code, an ESOP loan generally is exempt from the prohibitions provided in section 4975(c) of the Code and the excise taxes imposed by section 4975(a) and (b) of the Code, only if the loan is primarily for the benefit of the participants and beneficiaries of the plan (the "primary benefit requirement"). Section 54.4975-7(b)(3) of the regulations provides that all of the surrounding facts and circumstances will be considered in determining whether an ESOP loan satisfies the primary benefit requirement. Among the relevant facts and circumstances are whether the transaction promotes employee ownership of employer stock, whether contributions to the ESOP are recurring and substantial, and the extent to which the method of repayment of the loan benefits the employees. All aspects of the loan transaction, including the method of repayment, will be scrutinized to determine whether the primary benefit requirement is satisfied.

Section 54.4975-7(b) of the regulations indicates that the employer has the primary responsibility for the repayment of an exempt loan through contributions to the plan. Section 54.4975-7(b)(6) of the regulations provides for the repayment of the loan in the event of default. However, the exemption provided by section 4975(d)(3) of the Code, and described in the associated regulations, will not fail to be met merely because the trustee sells the unallocated suspense account shares and used the proceeds to repay the exempt loan, if such transaction satisfies the primary benefit requirement based on all the surrounding facts and circumstances.

It is represented that since the Original Transaction, Company A has contributed sufficient funds to enable Plan X to enable it to make all payments on a timely basis. As a result of the unanticipated offer to purchase all of Company A stock by Company C, Company A stock held in the suspense account was sold at a significant premium, and the portion of the proceeds remaining after repayment of the loan will be allocated to the ESOP participants. The ESOP will be terminated as soon as the escrow amounts are released from escrow and allocated to participants' accounts.

Upon consideration of all the surrounding facts and circumstances of this case, in accordance with section 54.4975-7(b)(3) of the regulations, we conclude, with respect to your first ruling request, that, the use of the cash proceeds of the sale of the Shares held by Plan X to repay Plan X's indebtedness does not cause the Loan to fail to satisfy the requirements for exemption under section 4975(d)(3) of the Code.

With respect to your second ruling request, section 415(a) of the Code provides that contributions and other additions under a defined contribution plan with respect to a participant for any taxable year may not exceed the limits of subsection (c). Section 415(a)(1)(B), generally, prohibits contributions and other additions under all defined contribution plans of an employer, including an ESOP, with respect to any participant for any limitation year from exceeding the limitations in section 415(c). Section 415(c)(1) of the Code provides that contributions and other additions with respect to a participant shall not, when expressed as an "annual addition" to the participant's account, exceed the lesser of (A) $40,000 or (B) 100% of the participant's compensation. Section 415(c)(2) defines "annual addition" as the sum for any year of employer contributions, the employee contributions, and forfeitures.

Section 415(c)(6) of the Code provides that if no more than one-third of the employer contributions to an employee stock ownership plan are allocated to highly compensated employees, then certain forfeitures and certain contributions used to repay interest on the exempt loan are not subject to the limitations imposed by section 415.

Section 1.415-6(g) of the regulations sets forth special rules for employee stock ownership plans. Section 1.415-6(g)(5) provides, in part, that for purposes of applying the limitations of section 415(c) of the Code and section 1.415-6(g) of the regulations, the amount of employer contributions which is considered an annual addition for the limitation year is calculated with respect to employer contributions of both principal and interest used to repay the exempt loan for that limitation year.

Section 1.415-6(b)(2)(i) of the regulations provides that the Commissioner may, in appropriate cases, considering all of the facts and circumstances, treat certain allocations to participant accounts as giving rise to annual additions.

Section 54.4975-7(b)(8)(i) of the regulations provides, in part, that an exempt loan must provide for the release from encumbrance under this subdivision (i) of plan assets used as collateral for the loan. For each plan year during the duration of the 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 the fraction is the amount of the principal and interest paid for the year. The denominator of the fraction is the sum of the numerator plus the principal and interest to be paid for all future years.

The proceeds used to repay the Loan result from the sale of the Shares to Company D in a bona fide transaction, and do not result from employer contributions, employee contributions, or forfeitures. The Excess Sale Proceeds reflects the extent of the appreciation in the value of the Shares held in the suspense account.

As previously noted, section 1.415-6(b)(2)(i) of the regulations provides that the Commissioner may, in appropriate cases, considering all of the facts and circumstances, treat certain allocations to participant accounts as giving rise to annual additions. In the present case the proceeds result from the repayment of the loan following the sale of the unallocated plan assets to Company D. In this transaction we have determined that no employer contributions were used to repay the loan. Accordingly, in our view, the facts and circumstances of the present case do not support the recharacterization of the ESOP suspense account allocations as annual additions under the authority of section 1.415-6(b)(2)(i).

Accordingly, we conclude with respect to your second ruling request that any allocation of Excess Sale Proceeds made to the accounts of the participants of Plan X as a result of the Transaction will not constitute annual additions to participants' accounts for purposes of Section 415 of the Code when allocated to the participants' accounts.

In reaching these conclusions, we have assumed that (i) the loan extended by Company A to Plan X is an exempt loan under section 4975(d)(3) of the Code at all relevant times, (ii) Plan X qualifies under section 401(a)of the Code and its ESOP portion and constitute an ESOP under section 4975(e)(7) at all relevant times and (iii)

the allocations as described in your second ruling request will not violate section 401(a)(4).

No opinion is expressed as to the federal tax consequences of the transaction described above under any other provisions of the Code.

Also, we express no opinion as to whether the subject transactions comply with Title I of Employee Retirement Income Security Act (ERISA,) because Title I of ERISA is within the jurisdiction of the Department of Labor.

This ruling is directed only 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.

A copy of this letter is being sent to your authorized representative in accordance with a power of attorney on file in this office. If you have any questions concerning this private letter ruling, please contact ********** (ID: **-*****) at (***) ***-**** (not a toll-free number).

Sincerely Yours,

Frances V. Sloan

Frances V. Sloan, Manager
Employee Plans Technical Group 3

CC: