Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Contact Person:

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T:EP:RA:T4

In Reference to:

D SEP 12 2000

Attn: 1

LEGEND:

Company A =

Plan X =

Dear

This is in response to a ruling request dated requested by your authorized representative, for rulings under sections 404(k), 72(t) and 3402 of the Internal Revenue Code ("Code").

In support of your ruling request your authorized representative has presented the following facts:

Company A established the predecessor to Plan X effective Plan X consists of a cash or deferred component ("CODA component") and an employee stock ownership component ("ESOP component"). All common stock of Company A held by Plan X is held under the ESOP component of the Plan. Plan X is qualified under section 401(a) of the Code and its trust is exempt from tax under section 501(a).

Plan X provides that eligible employees may elect, pursuant to a salary reduction agreement, to reduce compensation by any whole percentage (up to 20%) and have the resulting amount contributed to Plan X on a pre-tax basis ("elective deferral"). Plan X also provides that employees may make elective deferrals on cash bonuses.

Prior to , the Trustee of Plan X was authorized to acquire Company A stock pursuant to a loan that was exempt from the prohibitions of section 4975 of the Code by reason of

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section 4975(d)(3) (an "exempt loan"). Plan X provided that all dividends paid on Company A stock acquired pursuant to an exempt loan were applied to repay the exempt loan. Effective , no exempt loan will be outstanding and Plan X will be amended and restated to remove the leveraging features. After the restatement, Plan X will provide that dividends paid on or after , on Company A stock allocated to participant's accounts in the ESOP Component will be allocated to participant's accounts under the ESOP and pending distribution, will be invested in the Plan's money market account, unless the plan's administrative committee directs that such shares will be invested in additional shares of Company A stock. Dividends paid on Company A stock on or after that have not been allocated to a Matching Contributions Account (ESOP Dividends) will be distributed in cash to participants, exclusive of any earnings, not later than ninety (90) days after the close of the plan year.

Plan X, as restated, will provide for additional elective deferral under the CODA component of Plan X of up to the full amount of the ESOP Dividend (but not to exceed 90% of the awards described in section 4.2 of the plan). An active participant will be deemed to have increased his or her salary reduction agreement by an amount equal to his or her ESOP Dividend unless the participant elects not to so increase his or her salary reduction agreement. The plan as restated will further allow for a participant modification of this election. Each participant of Plan X will receive, on an annual basis, a Form 1099-Dividends to report the total amount of ESOP dividends allocated to and distributed from the participant's accounts in the Plan.

Procedurally, the ESOP Dividend will be processed as follows:

The Trustee will pay all ESOP Dividends earned by active participants to Company A's (or a participating subsidiary's) payroll department. The Trustee will pay ESOP Dividends to non-active participants (e.g. terminated/retired employees) directly.

Under an agency relationship established between the Trustee and Company A's (or a participating subsidiary's) payroll department, such payroll department will process the ESOP Dividends paid with respect to active participants in the following manner:

(a) For active participants receiving ESOP Dividends, the payroll department would increase the amount of the first payroll check in the plan year to each such employee and include a notice that the payroll check includes the amount of the ESOP Dividends.

(b) For those active participants described in (a) whose salary reduction agreements have been increased to provide for an additional deferral of compensation in the amount of the ESOP Dividends, such amount (not to exceed 90% of the amounts described in section 4.2 of the plan) would be deducted from the participants' compensation (including bonuses) paid in payroll periods which end in the first ninety (90) days of the plan year and added to the amount normally contributed to Plan X for that period, subject to the limitations of sections 401(k), 402(g) and 415 of the Code.

All dividends paid to a participant during a year will be reported at the end of the year on FORM 1099-Div.

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

1. The dividends on Company A stock held under Plan X will be deductible by the Company under Code section 404(k) in the taxable year distributed or paid by the Plan to participants, provided such dividends are paid as described above to participants (or their beneficiaries) no later than 90 days after the close of the Plan Year in which the dividends are paid to the Plan.

2. Payment of the ESOP Dividends in the manner described above will not result in the imposition of the ten percent (10%) additional tax imposed by Section 72(t) of the Code.

3. If a participant defers current compensation under the procedures described above, the amount so deferred will not constitute wages subject to income tax withholding under Code Section 3402.

Section 404(k)(1) of the Code provides that, in the case of a corporation, there shall be allowed as a deduction for a taxable year the amount of any applicable dividend paid in cash by such corporation during the taxable year with respect to applicable employer securities. Such deduction is in addition to the deductions allowed under section 404(a).

Section 404(k)(2) of the Code provides, in relevant part, that the term "applicable dividends" means any dividend which, in accordance with the plan provisions is paid to the plan and is distributed in cash to the participants in the plan, or their beneficiaries, not later than 90 days after the close of the plan year in which paid.

Section 404(k)(3) of the Code provides that for purposes of this subsection, "applicable employer securities" means with respect to any dividend, employer securities which are held on

the record date for such dividend by an employee stock ownership plan which is maintained by -- (A) the corporation paying such dividend, or (B) any other corporation which is a member of a controlled group of corporations (within the meaning of section 409(l)(4)) which includes such corporation.

Section 404(k)(6)(A) of the Code provides that for purposes of section 404(k), "employer securities" has the meaning given such term by section 409(l) of the Code.

Section 409(l) of the Code provides that the term "employer securities" means common stock issued by the employer (or by a corporation that is a member of the same controlled group) which is readily tradable on an established securities market.

Section 404(k)(5)(A) of the Code provides that the Secretary may disallow the deduction under paragraph (1) for any dividend if the Secretary determined that the dividend constitutes, in substance, an evasion of taxation.

Based on your representations, the subject dividends on Company A stock allocated to the plan participants' ESOP accounts will be paid to the plan participants within 90 days of the close of the plan year.

Accordingly, we conclude that the dividends paid on Company A stock held under the ESOP Component will be deductible by Company A under Code section 404(k) in the taxable year distributed or paid by the Plan to participants, provided such dividends are paid as described above to participants (or their beneficiaries) no later than 90 days after the close of the Plan Year in which the dividends are paid to the plan.

With respect to your second ruling request, section 72(t)(1) of the Code provides that if any taxpayer receives any amount form a qualified retirement plan, the taxpayer's tax for the taxable year in which such amount is received shall be increased by an amount equal to ten percent (10%) of the portion of such amount which is includible in gross income.

Section 72(t)(2)(vi) provides that, except as provided in paragraphs (3) and (4), which are not applicable to this case, paragraph (1) shall not apply to distributions of dividends paid with respect to stock of a corporation which are described in section 404(k).

Since we have concluded that the ESOP dividends will be deductible under section 404(k) of the Code, the distributions will qualify for the exemption from the tax imposed under section 72(t)(1) provided in section 72(t)(2)(vi). Accordingly, we rule

that the payment of the ESOP Dividends in the manner described above will no result in the imposition of the ten percent(10%) additional tax imposed by section 72(t)(1) of the Code.

With respect to your third ruling request, section 402(e)(3) of the Code provides, in part, that contributions made by an employer on behalf of an employee to a trust which is part of a qualified cash or deferred arrangement shall not be treated as distributed or made available to the employee nor as contributions made to the trust by the employee merely because the arrangement includes provisions under which the employee has an election whether the contributions will be made to the trust or received by the employee in cash.

Section 1.401(k)-1(a)(2) of the Income Tax Regulations provides that, generally, a cash or deferred arrangement is an arrangement under which an eligible employee may make a cash or deferred election with respect to contributions to, or accruals or other benefits under, a plan that is intended to satisfy the requirements of section 401(a) of the Code.

Section 1.401(k)-1(a)(3)(i) of the regulations provides that a cash or deferred election is any election (or modification of an earlier election) by an employee to have the employer either -- (A) provide an amount to the employee in the form of a cash or some other taxable benefit that is not currently available, or (B) contribute an amount to a trust, or provide an accrual or other benefit, under a plan deferring the receipt of compensation. A cash or deferred election includes a salary reduction agreement between an employee and employer under which a contribution is made under a plan only if the employee elects to reduce cash compensation or to forgo an increase in cash compensation.

Section 1.401(k)-1(a)(3)(ii) of the regulations provides that a cash or deferred election can only be made with respect to an amount that is not currently available to the employee on the date of the election. Further, a cash or deferred election can only be made with respect to an amount that would (but for the cash or deferred election) become currently available after the later of the date on which the employer adopts the cash or deferred arrangement or the date on which the arrangement first becomes effective.

Section 1.401(k)-1(a)(3)(iii) of the regulations provides that cash or another taxable amount is currently available to the employee if it had been paid to the employee or if the employee is able currently to receive the cash or other taxable amount at the employee's discretion. An amount is not currently available to an employee if there is a significant restriction or limitation on the employee's right to receive the amount before a

particular time in the future. The determination of whether an amount is currently available to an employee does not depend on whether it has been constructively received by the employee for purposes of section 451 of the Code.

Section 1.401(k)-1(a)(4)(i) of the regulations provides that. A qualified cash or deferred arrangement is a cash or deferred arrangement that satisfies the requirements of paragraphs (b), (c), (d), and (e) of section 1.401(k)-1 and that is part of a plan that otherwise satisfies the requirements of section 401(a) of the Code.

Section 1.401(k)-1(a)(4)(ii) of the regulations provided that, except as otherwise provided in section 1.401(k)-1(f), elective contributions under a qualified cash or deferred arrangement are treated as employer contributions.

Section 1.401(k)-1(a)(4)(iii) of the regulations provides that, except as provided in section 402(g) of the Code and in section 1.401(k)-1(f), elective contributions under a qualified cash or deferred arrangement are neither includible in an employee's gross income at the time the cash or other taxable amounts would have been includible in the employee's gross income (But for the cash or deferred election), nor at the time the elective contributions are contributed to the plan.

Federal income tax withholding under section 3402(a) of the Code is imposed on "wages" as defined in section 3401(a). Section 3401(a)(12)(A) excepts from the definition of wages remuneration paid to, or on behalf of, an employee or his beneficiary from or to a trust described in section 401(a) which is exempt form tax under section 501(A) at the time of such payment, unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust. Section 31.3401(a)(12)-1(a) of the Employment Tax Regulations provides that "wages" does not include any payment made by an employer, on behalf of an employee or his beneficiary, into a trust, if at the time of such payment the trust is exempt from tax under section 501(a) as an organization described in section 401(a). Additional amounts that are deferred into the plan as a result of a deemed election as described above are elective contributions that are treated as employer contributions.

Accordingly, with respect to your third ruling request we conclude that if a participant defers compensation under the procedures described above, the amount so deferred will not constitute wages subject to income tax withholding under section 3402 of the Code.

The above ruling is based on the assumption that Plan X is qualified under section 401(a), 409 and 4975(e)(7), and the related trust is tax exempt under section 501(a) of the Code at all relevant times. In addition, we are assuming that the subject shares allocated to the participants' Plan X accounts are "applicable employer securities", within the meaning of section 404(k)(3) with respect to the subject dividends. We are not expressing any opinion as to whether the language of any particular amendment conforms to the requirements of sections 401(a), 401(k), or 4975 of the Code.

This ruling is also based on the assumption that the proposed dividends do not constitute, in substance, an evasion of taxation within the meaning of section 404(k)(5)(A) of the Code. We are expressing no opinion as to whether or not the disallowance of deductions provided for in that section would be applicable here.

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

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

Sincerely yours,

S/ John G. Riddle, Jr.

John G. Riddle, Jr.
Manager, Employee Plans
Technical Group 4
Tax Exempt and Government
Entities Division

Enclosures:
Deleted copy of letter
Notice of Intention to Disclose

cc: