Internal Revenue Service

SIGNIFICANT INDEX NUMBER:
404.15-00

Department of the Treasury

Washington, DC 20224

Person to Contact:

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Refer Reply to:
OP:E:EP:P:1

Date: DEC 14

Legend:

Company A =

Company B =

Country M =

Plan X =

Article Y =

Trust Z =

Dear

This is in response to your request for a private letter ruling dated August 20, 1996, as supplemented by subsequent correspondence, submitted by your authorized representative to the Office of the Associate Chief Counsel (Domestic) concerning the federal income tax consequences of the transactions described below. Ruling request 4, concerning section 404 of the Internal Revenue Code, has been forwarded to this office for separate reply. The following facts have been submitted in support of your ruling request.

Company A's parent corporation is Company B, a Country M corporation. Company A maintains Plan X, a qualified profit-sharing plan under section 401(a) of the Code with a qualified cash or deferred arrangement under section 401(k). In addition to the employees of Company A, the employees of a number of related employers participate in Plan X.

Plan X allows employee pre-tax and after-tax contributions of from 1 to 11 percent of compensation. The employer matching contributions are 100 percent of participant contributions up to 2 percent of base salary, plus 50 percent of participant contributions from above 2 percent to 6 percent of base salary.

In addition to the above employer matching contributions, Article Y has been added to Plan X to provide for U.S. employees

to receive contributions of shares (a Share Contribution) of Company B pursuant to a stock option plan similar to that provided to the employees of Company B. Company B's shares cannot be sold to its U.S. employees because its shares are not registered in the U.S. Instead, the shares are made available to U.S. employees as additional matching employer contributions pursuant to Article Y of Plan X. An eligible employee must have one year of service and commit to "save" (contribute to Plan X) at least 6 percent of base salary a year for five years. After five years of such "saving", the employee is entitled to a Share Contribution.

At the start of each employee's "savings period", Company B will issue stock options to Trust Z. At the end of the employee's "savings" period (if the five-year savings requirement has been met), the trustees of Trust Z will exercise the stock options to purchase Company B shares to the extent that the option price (85 percent of the market price at the beginning of the employee's savings period) is less than the current market price, by immediately selling a sufficient number of shares at fair market value to pay the option price, and then transfering the remaining shares to Plan X to be credited to the employee's account.

Based on the foregoing facts and representations, your authorized representative has requested the following ruling:

Whether Company A or the applicable employer is allowed a deduction under section 404(a) of the Code in an amount equal to the fair market value of the stock transferred to Plan X pursuant to Article Y of Plan X,

Section 404(a) of the Code and section 1.404(a)-1(b) of the Income Regulations provide that if contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, such contributions will not be deductible under section 162(relating to trade or business expenses) or section 212 (relating to expenses for the production of income); but if they satisfy the conditions of either of such sections, they shall be deductible under section 404(a). The deductible limit on the amount of contributions to a qualified profit-sharing plan for any taxable year under section 404(a)(3) is an amount not in excess of 15 percent of the compensation paid or accrued to the beneficiaries under the profit-sharing plan.

Section 4972 of the Code provides for the imposition of a tax on an employer equal to 10 percent of any nondeductible contribution under a qualified plan. A nondeductible contribution is the excess of the amount contributed for the taxable year by the employer to the plan, over the amount allowed as a deduction under section 404 for such contribution.

Rev. Rul. 73-583, 1973-2 C.B. 146, provides that the amount deductible under section 404(a)(3) with respect to a stock contribution to a qualified profit-sharing plan is the fair market value of the stock at the time it is contributed to the plan.

In the case at hand, the transfer of shares to Plan X results in a contribution, subject to the deduction limits under section 404(a), equal to the fair market value of the securities transferred to Plan X from Trust Z. Accordingly, we conclude that Company A or the applicable employer is allowed a deduction under section 404(a) of the Code in an amount equal to the fair market value of the stock transferred to Plan X pursuant to Article Y of Plan X.

The above ruling is based on the assumption that the value of the securities transferred to Plan X, together with any other employer contributions, fall within the section 404(a) deduction limits, or else is subject to the tax on nondeductible contributions under section 4972.

The above ruling is also based on the assumptions that Plan X is qualified under section 401(a) of the Code and that its related trust is tax-exempt under section 501(a) at all relevant times. No opinion is expressed as to the federal tax consequences of the transaction described above under any other provisions of the Code, nor is any issue addressed that might arise under Title I of the Employee Retirement Income Security Act of 1974.

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

Sincerely yours,

Ken Yednock

Ken Yednock
Chief, Employee Plans
Projects Branch 1

Enclosures:
Deleted Copy of Ruling
Notice of Intention to Disclose
Copy of Letter to Authorized Representative

cc: