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Internal Revenue Service

Department of the Treasury

Uniform Issue List Nos.: 401.04-00
402.01-00
404.00-00
415.02-00
4972.00-00

Washington, DC 20224

Contact Person:

Telephone Number:

In Reference to: OP:E:EP:T:4

Date: JUN 7 1999

Legend:

Company A =

Company B =

Company C =

Company D =

Court E =

Litigation F =

Plan X =

Account Y =

Dear

This is in response to a ruling request submitted on your behalf by your authorized representative in a letter dated March 7, 1997 and supplemented by additional correspondence dated April 2, 1997, December 19, 1997, March 4 1998, March 26, 1998, April 8, 1998, January 2, 1999, and January 13, 1999, in which you request rulings under sections 401(a)(4), 402, 404, 415, and 4972 of the Internal Revenue Code ("Code").

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The following facts and representations have been submitted on your behalf.

Company A was formed as a result of a reorganization under Chapter 11 of the Bankruptcy Code, effective September 11, 1996. As part of the plan of reorganization, Company B was merged into Company C. The surviving entity was Company A.

Prior to the reorganization, Company B sponsored Plan X, which is a defined contribution plan that provides for a cash or deferred arrangement under section 401(k) of the Code. As a result of the reorganization, Company A is the sponsor of Plan X.

A determination letter request was made for Plan X as restated to comply with the Tax Reform Act of 1986, and a subsequent determination letter request was made for Plan X with respect to further plan amendments. Two favorable determination letters were issued by the Internal Revenue Service with respect to these requests on July 26, 1996.

Plan X previously permitted participants to direct the investment of their pre-tax employee contributions in the Company B common stock fund, an investment option under Plan X. Subsequently, Company B amended Plan X to prevent additional purchases of Company B common stock. Participants could, however, continue to direct the trustee to sell Company B common stock.

As a result of the reorganization, all Company B common stock was retired and shares of the surviving company, Company A, were issued to certain classes of Company B's creditors. In conjunction with the reorganization, the holders of the Company B common stock were given warrants to purchase shares of common stock of the new Company A.

In July of 1994, the first of several class action lawsuits was filed in Court E against Company B and various defendants alleging violation of securities laws. The lawsuits were eventually consolidated in Court E as Litigation F.

On September 11, 1995, a Stipulation of Settlement ("Settlement") was entered into between class plaintiffs and Company B and other defendants. Under the terms of the Settlement, cash and shares of Company B common stock ("Settlement Proceeds") were to be allocated among class plaintiffs. Class plaintiffs for purposes of Litigation F were the purchasers of shares of Company B common stock during the period of October 15, 1993, through March 31, 1995, and who had suffered harm.

The Settlement required class plaintiffs to provide certain information regarding the plaintiffs' alleged losses incurred due to the alleged securities violations. The

Settlement also required such information to be filed in the form of a claim with the Claims Administrator authorized by Court E to review and handle claims.

Company D, as trustee of Plan X, filed a claim with the Claims Administrator of the Settlement on behalf of Plan X and the participants who had invested in Company B common stock during the period of the alleged violations ("Affected Participants"). The claim was honored and on May 9, 1997, Company D received cash and warrants representing Settlement Proceeds attributable to the Affected Participants ("401(k) Settlement Proceeds"). The cash proceeds equaled $931,587.37. On May 21, 1997, at the direction of Company A, Company D sold the warrants for approximately $48,528.41. The 401(k) Settlement Proceeds will be utilized to lessen the losses incurred by Affected Participants and to attempt to place those participants in the position that they would have been but for the alleged securities violations. The 401(k) Settlement Proceeds will not restore to any Affected Participant any amount which would exceed that which would have been in the participant's account but for the loss.

Company D placed all the 401(k) Settlement Proceeds in Account Y with Plan X identified as the owner. Assets in Account Y were invested in a Company D money market fund.

Company A proposes to have all 401(k) Settlement Proceeds deposited into the Plan X trust account. All current and former Affected Participants who are entitled to a portion of the 401(k) Settlement Proceeds and who have an account balance under Plan X shall receive an allocation to such account of his/her share of the 401(k) Settlement Proceeds. Former Affected Participants who have received a distribution and no longer have an account balance under Plan X shall have his/her share of the 401(k) Settlement Proceeds allocated to an account established under Plan X for each such Affected Participant. Such former Affected Participants will receive a distribution from Plan X of his/her share of the 401(k) Settlement Proceeds.

Based on the above facts and representations, Company A, through its authorized representative, has requested the following letter rulings:

(1) The allocation or distribution of the 401(k) Settlement Proceeds to Plan X Affected Participants will not be deemed to be "contributions" to Plan X for purposes of sections 404 and 4972 of the Code.

(2) The portions of the 401(k) Settlement Proceeds that are allocated to Plan X accounts will not result in taxable income to either the Affected Participants or their beneficiaries. The distributed portions of the 401(k) Settlement Proceeds will be treated as distributions from a qualified retirement plan.

(3) The allocation of the 401(k) Settlement Proceeds to an Affected Participant's Plan X account, or distribution of 401(k) Settlement Proceeds attributable to Plan X, will not constitute a contribution or other payment affecting the qualification of Plan X pursuant to either section 401(a)(4) of the Code or section 415 of the Code.

With respect to ruling requests (1) and (3), section 401(a)(4) of the Code provides generally that the contributions or benefits provided under a qualified plan may not discriminate in favor of highly compensated employees. Whether or not contributions under a plan are discriminatory is generally determined by comparing the amount of contributions allocated to accounts of highly compensated employees with the amount of contributions to accounts of nonhighly compensated employees.

Section 404(a) of the Code provides that contributions paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, if otherwise deductible, are deductible under section 404, subject to various limitations set forth in section 404(a).

Section 415(c) of the Code generally limits the amount of contributions and other additions under a qualified defined contribution plan with respect to a participant for a particular limitation year. Section 1.415-6(b)(2) of the Income Tax Regulations provides that the term "annual additions" includes employer contributions which are made under the plan. Section 1.415-6(b)(2) further provides that the Commissioner may, in an appropriate case, considering all of the facts and circumstances, treat transactions between the plan and the employer or certain allocations to participants' accounts as giving rise to annual additions.

Section 4972(a) of the Code imposes on the employer an excise tax on nondeductible contributions under a qualified plan. Section 4972(c) defines the term "nondeductible contributions" to mean the excess (if any) of the amount contributed for the taxable year by the employer to or under such plan over the amount allowable as a deduction under section 404 for such contributions, (determined without regard to subsection (e) thereof), and the amount determined under subsection (c) for the preceding year reduced by the sum of the portion of the amount so determined returned to the employer during the taxable year and the portion of the amount so determined deductible under section 404 for the taxable year (determined without regard to subsection (e) thereof).

With regard to your ruling request (2), section 402(a) of the Code generally provides that amounts held in a trust that is exempt from tax under section 501(a) of the Code and that is part of a plan that meets the qualification requirements of section 401(a) of the Code will not be taxable to participants until such time as such amounts are actually distributed to distributees under such plan. Further, amounts distributed will be

taxable to the distributee, in the taxable year of the distributee in which distributed, under section 72 of the Code.

Neither the Code nor the Income Tax Regulations promulgated thereunder provide guidance as to whether the proposed payment to Plan X of the 401(k) Settlement Proceeds constitutes a contribution for purposes of the above-referenced sections of the Code.

In this case, the payment to Plan X will ensure that the Affected Participants are placed in a position similar to that in which they would have been but for the alleged violation of securities laws by Company B. Thus, it is reasonable to characterize this payment as a replacement payment.

As indicated by the facts of this case, the replacement payment will be made to Plan X in response to the Settlement of Litigation F involving alleged violation of securities laws by Company B. The replacement payment will be allocated or distributed to those Affected Participants of Plan X.

Accordingly, we rule that the proposed replacement payment to Plan X, to be allocated or distributed to the Affected Participants as described above:

(1) will not constitute a "contribution" or other payment subject to the provisions of either section 404 of the Code or section 4972 of the Code;

(2) will not, when made to Plan X, result in taxable income to the Affected Participants or their beneficiaries, and will, when distributed, be subject to section 402 of the Code; and

(3) will not adversely affect the qualified status of Plan X pursuant to either section 401(a)(4) of the Code or section 415 of the Code.

The above rulings are based on the assumption that Plan X is qualified under section 401(a) of the Code and that its related trust is tax exempt under section 501(a) of the Code at all relevant times. No opinion is expressed as to the federal tax consequences of the transactions described above under any other provisions of the Code.

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

Sincerely yours,

John G. Riddle, Jr.

John G. Riddle, Jr.
Chief, Employee Plans
Technical Branch 4

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