200007038

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

SIN: 404.00-00; 4972.00-00; 415.00-00; 402.00-00

xxxxx
xxxxx
xxxxx

Attn: xxxxx

Contact Person:
xxxxx
Telephone Number:
xxxxx
In Reference to:
OP:E:EP:T:2/
Date:
NOV 24 1999

LEGEND:

Employer M = xxxxx

State B = xxxxx

Plan X = xxxxx

Date 1 = xxxxx

Date 2 = xxxxx

Sum 1 = xxxxx

Sum 2 = xxxxx

Dear xxxxx:

This is in response to a letter dated xxxxx, 1999, as supplemented by letters dated xxxxx, 1999, and xxxxx, 1999, in which your authorized representative requested private letter rulings on your behalf relating to the Federal income tax consequences of a legal settlement fund being paid into a qualified plan.

Employer M is the sponsor and trustee of Plan X. Plan X is an employee stock ownership plan, as defined in section 4975(e)(7) of the Internal Revenue Code (ESOP), to which a cash or deferred arrangement as described in section 401(k)(2) of the Code was added pursuant to an amendment and restatement of Plan X effective April 1, 1997. Plan X is the successor to two merged ESOPs which were adopted by Employer M effective June 24, 1986 ("former ESOP"). Your authorized representative asserts that Plan X is qualified within the meaning of section 401(a) of the Code, and its trust is exempt from tax under section 501(a) of the Code. Plan X's most recent favorable determination letter is dated January 11, 1999.

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On Date 1, a group of current and former participants and beneficiaries in Plan X (referred to hereinafter as "the Class") filed a class action suit against Employer M and other defendants on account of certain plan issues that began when the former ESOP was in effect. The suit, filed in the United States District Court in State B, the location of Employer M's principal office, alleged violations under the Employee Retirement Income Security Act of 1974 (ERISA), under the Racketeer Influenced and Corrupt Practices Act (RICO), under Federal and state securities laws, and under various other statutes and common law. The Class claimed that various acts or omissions relating to alleged breaches of fiduciary duty and other violations of applicable laws caused, among other things, incorrect valuations of stock purchased and sold in the former ESOP which, in turn, resulted in loss of principal.

In order to resolve actual and potential claims by Class members, Employer M and the other defendants, pursuant to signed settlement agreements approved by the court, agreed to restore the losses to Plan X by making a collective payment of Sum 1 in cash into a qualified settlement fund ("Settlement Fund") under section 1.468B-1 of the Income Tax Regulations.

In the Final Order and Judgment entered on Date 2, the court appointed a third party administrator of the Settlement Fund ("Settlement Administrator"). Payments were then made to the Settlement Fund. The Settlement Administrator intends to deposit the Settlement Fund in its entirety, less administrative costs and costs of mailing notice to the Class, into Plan X. This net payment of the Settlement Fund, less costs, is the "Restoration Payment" that will be made to eligible Class members in settlement of the legal action and potential legal actions. The Settlement Administrator intends to make two allocations of the Restoration Payment to Class members.

One allocation is based on the determination that because all participants in Plan X suffered from alleged non-pecuniary wrongdoing by Employer M and the other defendants, all Class members not excluded by the Court will receive a minimum allocation of Sum 2. The Court determined that all Plan X participants who sold shares of stock through Plan X at or above a certain price per share were deemed to be undamaged. Consequently, any member of the Class who did not sell any shares of stock for less than the price determined by the Court will not receive the Sum 2 allocation.

The other allocation to Class members will be made from the Settlement Fund in an amount equal to what would have been his or her proportional share of the stock held in Plan X had Plan X purchased and sold shares at the more appropriate historical stock prices (determined by calculating the number of shares that would have been purchased and sold at appropriate historical stock prices and using the actual dollar amounts used to purchase shares and the actual dollar amounts received from the sale of shares in Plan X). No member of the Class will receive an allocation greater than his or her actual losses as the total amount available from the Settlement Fund is less than the actual amount of loss suffered by the Class members as a result of the erroneous valuations of the stock.

Since Plan X participants were permitted to purchase stock with rollover contributions to Plan X, the allocation method assures that no one person is overly enriched or harmed in the allocation process as a result of having rolled over substantial sums of money into Plan X in any one year. This is accomplished by identifying those Class members who made a net purchase of Plan X shares in any one year and limiting those person to no more than a $30,000 purchase for that year. The $30,000 amount is the applicable annual contributions limitation imposed pursuant to section 415 of the Code. Any additional amounts were carried forward to subsequent years when the Class member did not exceed the $30,000 limit.

Based on the above facts and representations, the following rulings have been requested:

1. The Restoration Payment will not be considered a contribution or other payment subject to the provisions of either section 404 or section 4972 of the Code.

2. The Restoration Payment will not affect the qualified status of the Plan under section 401(a)(4) of the Code.

3. The Restoration Payment will not affect the qualified status of the Plan under section 415 of the Code.

4. The Restoration Payment will not constitute taxable income to Plan participants or their beneficiaries.

Section 401(a)(4) of the Code provides that the contributions or benefits provided under a retirement plan qualified under section 401(a) of the Code may not discriminate in favor of highly compensated employees as defined in section 414(q) of the Code.

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Section 415(a) of the Code provides, in part, that a trust which is part of a pension, profit-sharing, or stock bonus plan shall not constitute a qualified trust under section 401(a) if--

(A) in the case of a defined benefit plan, the plan provides for the payment of benefits with respect to a participant which exceeds the limitation of subsection (b) or

(B) in the case of a defined contribution plan, contributions and other additions under the plan with respect to any participant for any taxable year exceed the limitations of subsection (c).

Section 415(e) of the Code provides limitations on employer contributions and benefits in the case where an individual is a participant in both a defined benefit and a defined contribution plan maintained by the same employer.

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 of the Code imposes on an employer an excise tax on nondeductible contributions to a qualified plan. Section 4972(c) defines "nondeductible contributions" as 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 of the Code 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).

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 plan that meets the qualification requirements of Code section 401(a) will not be taxable to participants until such time as such

amounts are actually distributed to distributees under such plan.

Neither the Code nor the Income Tax Regulations promulgated thereunder provide guidance as to whether Employer M's proposed Restorative Payment should constitute contributions for purposes of the above-referenced sections of the Code.

In this case, the payment which Employer M intends to make to Plan X, which payment is referred to above, will ensure that the affected participants in Plan X recover a portion of their account balances and place them in a position similar to that in which they would have been in the absence of the alleged activity by Employer M referenced above pursuant to which Plan X stock was valued incorrectly causing a loss to participants. 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 by Employer M in response to potential claims against Employer M. The replacement payment will be allocated to the accounts of participants and beneficiaries under Plan X which incurred a loss as a result of alleged Employer M action which resulted in incorrect valuation of Plan X stock.

Thus, based on the above, we conclude as follows with respect to your ruling requests:

1. The Restoration Payment will not be considered a contribution or other payment subject to the provisions of either section 404 or section 4972 of the Code.

2. The Restoration Payment will not affect the qualified status of the Plan under section 401(a)(4) of the Code.

3. The Restoration Payment will not affect the qualified status of the Plan under section 415 of the Code.

4. The Restoration Payment will not constitute taxable income to Plan participants or their beneficiaries.

This ruling assumes that Plan X will meet the qualification requirements of section 401(a) of the Code and that its related trust is tax-exempt within the meaning of section 501(a) of the Code at the time that the transaction as described herein occurs. No opinion is expressed as to the Federal tax consequences of the transaction described above under any other provision of the Code.

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

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

Sincerely yours,

(signed) JOYCE E. FLOYD

Joyce E. Floyd
Chief, Employee Plans
Technical Branch 2

Enclosures:
Deleted Copy of Letter
Notice of Intention to Disclose

cc:
Director, xxxxx Key District
Attn: Chief, EP/EO

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