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**Internal Revenue Service**

199929045

Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply to: OP:E:EP:T:3

Date: APR 27 1999

LEGEND:

Company M:

Plan X:

Dear

This is in response to a request for a private letter ruling dated December 16, 1998, as supplemented by letters dated March 17, 1999, and April 19, 1999, submitted on your behalf by your authorized representative, with respect to the federal income tax consequences of transactions described below involving Plan X.

In support of your request, your authorized representative has submitted the following facts and representations:

Company M maintains Plan X, an employee stock ownership plan ("ESOP") which is intended to be qualified under section 401(a) of the Internal Revenue Code and to meet the requirements of section 4975(e)(7) of the Code. Plan X is designed to invest primarily in Company M securities, which consist of common stock. In 1984, Company M borrowed funds from unrelated lenders and loaned the entire proceeds to Plan X (the "Exempt Loan"). The Exempt Loan is intended to meet the requirements of Code section 4975(d)(3). Plan X used the proceeds of the Exempt Loan to acquire common stock at a price of $30.40 per share, which was placed in the Plan X suspense account for release and allocation in proportion to the payment of principal and interest on the Exempt Loan. As of December 31, 1997, the value per share of Company M stock was $16.50 per share. As of January 1, 1998, there were approximately 4.5 million shares remaining in the Plan X suspense account.

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Company M currently calculates annual additions based on the pro-rata share of cash contributions made to Plan X to make principal and interest payments on the Exempt Loan. These cash contributions reflect the purchase price of the shares held in the suspense account. Since the current fair market value of the shares in suspense is less than their purchase price, annual additions currently exceed the fair market value of the shares upon allocation to participant accounts. To alleviate this situation, Company M proposes to amend Plan X to provide that, in the case of shares of Company M stock released from suspense and allocated to the ESOP account of a participant for a particular plan year, Company M shall determine for such year that an annual addition will be calculated on the basis of the fair market value of shares of Company M stock so released and allocated (such fair market value to be based on the valuation as of the valuation date immediately preceding the plan year in respect of which the release and allocation are made) if the annual addition as so calculated is lower than the annual addition calculated on the basis of Company M contributions. The amendment is effective for limitation years beginning after December 31, 1998. Company M further proposes to continue to deduct the full amount of the cash contributions actually paid to Plan X, subject to the limits of Code section 404(a)(9).

Based on the foregoing facts and representations, rulings to the following effect are requested:

1. The determination of annual additions on the basis of the fair market value of the shares released from suspense will not cause Plan X to fail to meet the requirements of Code sections 401(a)(16) and 415(c).
2. The calculation of annual additions based on the current fair market value of shares released from suspense will not affect Company M's deduction under Code section 404(a)(9) for cash contributions to Plan X.

With respect to ruling request one, Code section 401(a)(16) provides that a qualified plan may not provide for benefits or contributions in excess of the limitations set forth in section 415.

Code section 415(a) provides that contributions and other additions under a defined contribution plan with respect to a participant for any taxable year may not exceed the limitation of subsection (c). Section 415(c)(1) provides that contributions and other additions with respect to a participant, when expressed as an annual addition, shall not exceed certain specified limits. Section 415(c)(2) defines "annual addition" as the sum for any year of employer contributions, the employee contributions, and forfeitures.

Section 1.415-6(g) of the Income Tax Regulations sets for the special rules for ESOPs. Section 1.415-6(g)(5) provides, in pertinent part, that for purposes of applying the limitations of section 415(c) of the Code and section 1.415-6 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 54.4975-11(a)(8)(ii) of the Excise Tax Regulations provides that an ESOP will not fail to meet the requirements of section 401(a)(16) merely because annual additions under section

415(c) are calculated with respect to employer contributions used to repay an exempt loan rather than with respect to securities allocated to participants.

In this case, Plan X currently uses the pro-rata share of employer contributions to calculate annual additions. In accordance with the proposed amendment, Plan X will calculate annual additions based on the fair market value of the shares released from suspense.

The method of calculating annual additions is not specifically prescribed by the regulations. However, section 54.4975-11(a)(8)(ii) of the regulations does provide that annual additions may be calculated with respect to either employer contributions used to repay the exempt loan or to the securities allocated to participants.

Therefore, with respect to ruling request one, we conclude that the determination of annual additions on the basis of the fair market value of the shares released from suspense will not cause Plan X to fail to meet the requirements of sections 401(a)(16) and 415(c).

With respect to ruling request two, Code section 404 sets for the the rules governing the employer's deduction for contributions to a qualified employer's plan.

Section 404(a) provides generally 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.

Section 404(a)(9) of the Code provides under subparagraph (A) that if contributions are paid into a trust which forms part of an ESOP and such contributions are, on or before the time prescribed in paragraph (6), applied by the plan to the repayment of the principal of a loan incurred for the purpose of acquiring qualifying employer securities, such contributions shall be deductible under this paragraph for the taxable year determined under paragraph (6). The amount deductible shall not exceed 25 percent of the compensation otherwise paid or accrued during the taxable year to the employees under such ESOP. Subparagraph (B) provides that if contributions are made to an ESOP and such contributions are applied by the plan to the repayment of interest on a loan incurred for the purpose of acquiring qualifying employer securities, such contributions shall be deductible for the taxable year with respect to which such contributions are made as determined under paragraph (6).

In this case, cash contributions to Plan X will be applied by Plan X toward repayment of the principal and interest of a loan incurred for the purpose of acquiring qualifying employer securities. Section 404(a)(9) does not limit the deduction of such contributions to those situations where the annual additions under section 415 are based upon the employer's contributions to the ESOP as opposed to the fair market value stock released from the plan's suspense account.

Thus, with respect to ruling request two, we conclude that the calculation of annual additions based on the current fair market value of shares released from the Plan X suspense account will not affect Company M's deduction under Code section 404(a)(9) for cash contributions to Plan X.

The above ruling is based on the assumptions that Plan X is qualified under Code sections 401(a) and 4975(e)(7) and that its related trust is tax-exempt under Code section 501(a) at all relevant times.

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

Sincerely yours,

Frances V. Sloan

Frances V. Sloan
Chief, Employee Plans
Technical Branch 3

Enclosures:
Notice of Intention to Disclose
Deleted Copy of Letter

Cc: