199948038

Internal Revenue Service

Department of the Treasury

UIL: 9999.98-00

Washington, DC 20224

Person to Contact:

Telephone Number:

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

Date: SEP 8 1999

LEGEND:

Company A:

Plan X:

Dear

This letter is in response to a request for a ruling letter submitted on your behalf by your authorized representative on February 24, 1999, as supplemented by letters dated July 9, 1999, and August 25, 1999. This request concerns the consequences for an employee stock ownership plan ("ESOP") under Internal Revenue Code ("Code") sections 4975(d)(3) and 4975(e)(7) of using certain earnings to repay an exempt loan.

Your authorized representative has submitted the following facts and representations in support of the requested rulings:

Company A, an S corporation since November 1, 1998, established Plan X, a stock bonus plan, effective as of October 28, 1990. Plan X is a leveraged ESOP which is intended to meet the requirements of Code sections 401(a) and 4975(e)(7).

Plan X has borrowed funds from Company A to purchase shares of Company A stock. These loans (the "Exempt Loans") were intended to be exempt loans as described in Code section 4975(d)(3). The Exempt Loans are being repaid over a multi-year period using contributions from Company A (and its affiliates) to Plan X and any earnings on the shares purchased with the proceeds of the Exempt Loans. Collateral for the Exempt Loans consists of unallocated shares of the purchased Company A stock held in Plan X loan suspense accounts.

Company A intends to make the maximum contributions to Plan X permitted under Code section 404. To the extent that such contributions are not sufficient to make the annual payments on the Exempt Loans, Plan X will use earnings on unallocated shares of Company A stock held in the loan suspense accounts to make such annual payments. These earnings may

include dividends to the extent that Company A has accumulated earnings and profits from its prior status as a C corporation. If employer contributions and dividends are not sufficient to allow Plan X to make the annual Exempt Loans payments, then additional amounts will come from Company A's accumulated adjustments account ("AAA") maintained in accordance with Code section 1368. This AAA is not increased by capital contributions. All amounts held within Company A's AAA would be payable as dividends under Code section 301 if Company A had remained a C corporation.

Based on the foregoing facts and representations, your authorized representative has requested the following ruling, in place of others originally requested, on your behalf:

1. To the extent that the Plan X fiduciaries use the earnings (whether dividends or otherwise) received on unallocated shares of Company A stock held in the suspense account to repay the Exempt Loan, the transactions will not cause the Exempt Loan to fail to satisfy section 4975(d)(3) of the Code.

Code section 401(a) provides that a trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section if certain requirements are met.

Code section 4975(e)(7) generally defines an ESOP as a defined contribution plan which is a stock bonus plan which is qualified, or a stock bonus and a money purchase plan both of which are qualified under section 401(a), and which are designed to invest primarily in qualifying employer securities.

Code section 4975 imposes a tax on prohibited transactions, but provides an exemption in section 4975(d)(3) for a loan to a leveraged ESOP (as defined in section 4975(e)(7)) if such loan is primarily for the benefit of participants and beneficiaries of the plan. Requirements concerning the interest rate and collateral must also be met.

Section 54.4975-7(b)(2)(ii) provides that exempt loans will be subjected to special scrutiny to ensure that they are primarily for the benefit of participants and their beneficiaries.

Section 54.4975-7(b)(3) of the regulations states that an exempt loan must be primarily for the benefit of the ESOP participants and their beneficiaries, and that all of the surrounding facts and circumstances will be considered in determining whether the loan satisfies this requirement. It further states that no loan will satisfy this requirement unless it satisfies the requirements of section 54.4975-7(b)(5).

Section 54.4975-7(b)(5) of the regulations states in part that no person entitled to payment under the exempt loan shall have any right to assets of the ESOP other than (i) collateral given for the loan, (ii) contributions (other than contributions of employer securities) that are made under an ESOP to meet its obligations under the loan, and (iii) earnings attributable to such collateral and the investment of such contributions. The regulation further states that the payments made with respect to an exempt loan by the ESOP during a plan year must not exceed

an amount equal to the sum of such contributions and earnings received during or prior to the year less such payments in prior years.

In the present case, since the unallocated shares are held in the suspense account as collateral for the Exempt Loan, the earnings attributable to such shares may be used to make payments on the Exempt Loan to the extent that these earnings are from either accumulated earnings and profits or from the AAA. Therefore, with respect to your requested ruling, we conclude that to the extent that the Plan X fiduciaries use the earnings (whether dividends or otherwise) received on unallocated shares of Company A stock held in the suspense account to repay the Exempt Loan, the transactions will not cause the Exempt Loan to fail to satisfy section 4975(d)(3) of the Code if such earnings are from either accumulated earnings and profits or from the AAA maintained by Company A.

This ruling letter is based on the assumption that Plan X continues to be otherwise qualified under Code sections 401(a) and 4975(e)(7) at all relevant times. This ruling is also based on the assumption that the AAA satisfies the requirements of Code section 1368 at all relevant times.

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

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

Sincerely yours,

Frances V. Sloan

Frances V. Sloan
Chief, Employee Plans
Technical Branch 3

Enclosures
Notice 437
Deleted copy of ruling letter

cc: