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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Contact Person:

Telephone Number:

In Reference to:

Date: OP:E:EP:T:3

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Attention:

Legend

Company A =

Company B =

Plan X =

Fund M =

Dear

This is in reply to your ruling request of October 11, 1998, submitted on your behalf by your authorized representative, regarding the federal income tax consequences of certain amendments to Plan X. The request was supplemented by letters dated April 24, 1998, January 19, 1999, and April 1, 1999. The following facts and representations have been submitted by your authorized representative.

Company A, the taxpayer, is the parent corporation of Company B, the principal subsidiary corporation of Company A

Company B established Plan X, effective January 1, 1984. Plan X was amended and restated November 14, 1994, effective as of January 1, 1989. Plan X received a favorable determination letter as to the Plan's qualified status under Section 401(a) of the Internal Revenue Code, as amended by the Tax Reform Act of 1988 (and subsequent legislation).

Plan X is a stock bonus plan, with a cash or deferred arrangement, which covers all persons employed by Company B, except union employees whose collective bargaining agreement does not provide for their participation in Plan X. Company B includes Affiliated Companies,

which with Company B, are members of a controlled group under sections 414(b) or (c) of the Code or an affiliated group under section 1504.

Under Plan X, employees are permitted to make contributions on a pre-tax basis. Employees may also make after-tax contributions to the Plan. The maximum employee contributions (pm-tax or after-tax) percentage is 15% of eligible compensation. Additionally, Company B contributes to Plan X in the form of a match, the amount equal to one-half of the sum of each employee participants deferrals and after-tax contributions not exceeding six percent of eligible compensation. Company B's contributions include matching contributions from Affiliated Companies.

Under Plan X, employees elect to invest their contributions, Company B's contributions, and their account balances in one or a combination of six investment options, including Fund M, which invests solely in shares of Company A wmmon stock.

Effective February 26, 1998, Company A amended and continued Plan X so that the Fund M portion of Plan X will constitute an employee stock ownership plan ("ESOP") described in section 4975(e)(7) of the Code and section 407(d)(6) of the Employee Retirement Income Security Act of 1974 (ERISA). After the amendment, the non-ESOP and ESOP portions together will be a continuation of the stock bonus plan and are intended to continue to qualify under Code sections 401(a) and 401(k). The amendment provides that any cash dividends paid with respect to Company A stock allocated to the participants' ESOP acwunts (ESOP Dividends) will be paid to all participants and/or their beneficiaries unless the participants elect not to receive the dividends.

Company A proposes to further amend Plan X so as to allow Company A to adopt various methods of dividend payments. Company A also proposes to further amend Plan X to provide that unless an employee participant who is invested in Fund M elects otherwise, such employee participant will be deemed, subject to Plan X limit on pre-tax contributions and the limits of section 402(g) and section 415 of the Code and regulations thereunder, to have increased his or her pretax contribution election by the amount of the dividends paid on Company A stock allocated to his or her ESOP account.

The term "ESOP account", as used in this ruling request, refers to any participant's account established pursuant to section 4975(e)(7) to which has been allocated Company A stock.

Procedurally, Company B proposes that all ESOP dividends with respect to Plan X be paid in one of two ways: (1) directly to participants, or (2) to the trustee for further distribution to the participants. In each case, dividends will be distributed no later than 90 days after the close of the plan year in which the dividends were paid. In the case of (2) the trustee may appoint Company B's payroll department or another third party as its disbursing agent for the payment of dividends to participants who are active employees. Dividends paid to former employees and beneficiaries will be either paid directly by Company A or paid directly by the trustee to the former employee or beneficiary.

Based on the foregoing, you request the following rulings:

(1) The dividends on Company A stock held by Plan X that are paid directly in cash to the participants or to the trustee of Plan X and then distributed to the participants within 90 days of the dose of the plan year will be deductible by Company A in the year paid or distributed to the participants under section 404(k) of the Code.

(2) If a participant elects to make additional pretax contributions in the manner described above, the additional pre-tax contributions will not constitute wages subject to income tax withholding under section 3402 of the Code.

With respect to your first ruling request, section 404(k)(l) of the Code provides that, in the case of a corporation, there shall be allowed as a deduction for a taxable year the amount of any applicable dividend paid in cash by such corporation during the taxable year with respect to applicable employer securities. Such deduction is in addition to the deductions allowed under section 404(a).

Section 404(k)(2) of the Code provides, in relevant part, that the term "applicable dividend" means any dividend which, in accordance with the plan provisions is paid to the plan and is distributed in cash to the participants in the plan, or their beneficiaries, not later than 90 days after the close of the plan year in which paid.

Section 404(k)(3) of the Code provides that for purposes of this subsection, "applicable employer securities" means, with respect to any dividend, employer securities which are held on the record date for such dividend by ah employee stock ownership plan which is maintained by - (A) the corporation paying such dividend, or (B) any other corporation which is a member of a controlled group of corporations (within the meaning of section 409(e)(4) which includes such corporation).

Section 1.404(k)-1T, Q&A 2 of the Temporary Income Tax Regulations provides that the deductibility of dividends paid to plan participants under section 404(k) of the Code is not affected by a plan provision which permits participants to elect to receive or not receive payment of dividends,

Section 404(k)@)(A) of the Code provides that the Secretary may disallow the deduction under paragraph (1) for any dividend if the Secretary determined that such dividend constitutes, in substance, an evasion of taxation,

Based upon your representations, the subject dividends on Company A stock allocated to the plan participants' accounts will be paid to the plan participants within 90 days of the close of the plan year, if they do not elect to have the dividends retained in Plan X.

Accordingly, we conclude with respect to your first ruling request that the dividends paid on Company A stock held by Plan X that are paid directly in cash to the participants or to the trustee of Plan X and then distributed to the participants within 90 days of the close of the plan

year will be deductible by Company A in the year distributed or paid under section 404(k) of the Code.

With respect to your second ruling request, section 402(e)(3) of the Code provides, in part, that contributions made by an employer on behalf of an employee to a trust which is a part of a qualified cash or deferred arrangement shall not be treated as distributed or made available to the employee nor as contributions made to the trust by the employee merely because the arrangement includes provisions under which the employee has an election whether the contributions will be made to the trust or received by the employee in cash.

Section 1.401(k)-l(a)(2) of the Income Tax Regulations provides that, generally, a cash or deferred arrangement is an arrangement under which an eligible employee may make a cash or deferred election with respect to contributions to, or accruals or other benefits under, a plan that is intended to satisfy the requirements of section 401(a) of the Code.

Section 1.401(k)-l(a)(3)(i) of the regulations provides that a cash or deferred election is any election (or modification of an earlier election) by an employee to have the employer either - (A) provide an amount to the employee in the form of a cash or some other taxable benefit that is not currently available, or (B) contribute an amount to a trust, or provide an accrual or other benefit, under a plan deferring the receipt of compensation. A cash or deferred election includes a salary reduction agreement between an employee and employer under which a contribution is made under a plan only if the employee elects to reduce cash compensation or to forgo an increase in cash compensation.

Section 1.401(k)-1(a)(3)(ii) of the regulations provides that a cash or deferred election can only be made with respect to an amount that is not currently available to the employee on the date of the election. Further, a cash or deferred election can only be made with respect to an amount that would (but for the cash or deferred election) become currently available after the later of the date on which the employer adopts the cash or deferred arrangement or the date on which the arrangement first becomes effective.

Section 1.401(k)-1(a)(3)(iii) of the regulations provides that cash or another taxable amount is currently available to the employee if it has been paid to the employee or if the employee is able currently to receive the cash or other taxable amount at the employee's discretion. An amount is not currently available to an employee if there is a significant restriction or limitation on the employee's right to receive the amount before a particular time in the future. The determination of whether an amount is currently available to an employee does not depend on whether it has been constructively received by the employee for purposes of section 451 of the Code.

Section 1.401(k)-l(a)(4)(i) of the regulations provides that, a qualified cash or deferred arrangement is a cash or deferred arrangement that satisfies the requirements of paragraphs (b), (c), (d), and (e) of section 1.401(k)-1 and that is part of a plan that otherwise satisfies the requirements of section 401 (a) of the Code.

Section 1.401(k)-1(a)(4)(ii) of the regulations provides that, except as otherwise provided in section 1.401(k)-1 (9, elective contributions under a qualified cash or deferred arrangement are treated as employer contributions.

Section 1.401(k)-1(a)(4)(iii) of the regulations provides that, except as provided in section 402(g) of the Code and in section 1.401(k)-1(f), elective contributions under a qualified cash or deferred arrangement are neither indudible in an employee's gross inwme at the time the cash or other taxable amounts would have been includible in the employee's gross inwme (but for the cash or deferred election), nor at the time the elective contributions are contributed to the plan.

Federal inwme tax withholding under section 3402(a) of the Code is imposed on 'wages" as defined in section 3401(a). Section 3401(a)(12)(A) excepts from the definition of wages remuneration paid to, or on behalf of, an employee or his beneficiary from or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment, unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust. Section 31.3401(a)(12)-1(a) of the Employment Tax Regulations provides that 'wages" does not include any payment made by an employer, on behalf of an employee or his beneficiary, into a trust, if at the time of such payment the trust is exempt from tax under 501(a) as an organization described in section 401(a).

The additional pre-tax contributions made in the manner described above are elective contributions that are treated as employer contributions. Accordingly, with respect to your second ruling request we conclude that if a participant elects to make additional pm-tax contributions in the manner described above, the additional pm-tax contributions will not constitute wages subject to inwme tax withholding under section 3402 of the Code.

The above rulings are based on the assumption that Plan X will be qualified under sections 401(a), 401(k). 409, and 4975(e)(l) of the Code, as applicable, and the related trusts will be tax exempt under section 501(a) at the time that the above transaction takes place. In addition, we are assuming that the subject shares allocated to the participants' Plan X ESOP accounts are "applicable employer securities", within the meaning of section 404(k)(3) with respect to the subject dividends. We are not expressing any opinion as to whether the language of any particular amendment conforms to the requirements of sections 401(a), 401(k). or 4975 of the Code.

These rulings are also based on the assumption that the proposed dividend does not constitute. in substance, an evasion of taxation within the meaning of section 404(k)(5)(A) of the Code. We are expressing no opinion as to whether or not the disallowance of deductions provided for in that section would be applicable here.

We are also assuming that Plan X will be amended to reflect the method of dividend payment adopted by Company A for the distribution of dividends. Such method will stay in effect until the Plan X is further amended to adopt a different method of dividend payment.

This ruling is directed only to the taxpayer who requested it and applies only to Plan X as proposed to be amended as of the date of this ruling. Section 6110(j)(3) of the Code provides that this ruling may not be used or cited as precedent,

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

Sincerely yours,

Frances V. Sloan

Frances V. Sloan
Chief, Employee Plans
Technical Branch 3

Endosures:
Deleted copy of letter
Notice of Intention to Disclose