Internal Revenue Service

Department of the Treasury

200033047

UNIFORM ISSUE LIST: 404.00-00
3402.00-00
3301.00-00

Washington, DC 20224

Contact Person:

Telephone Number:

In Reference to:
T:EP:RA:T3
Date:

Attention:

MAY 22 2001

Legend:

Company A

Fund M

Plan X

Dear

This is in response to your request for a ruling dated July 8, 1997, submitted by your authorized representative in which rulings are requested under Sections 404(k) and 3402, 3111, and 4975 of the Internal Revenue Code of 1986 (the "Code") with respect to amendments to Plan X. Your request was supplemented by letters dated May 24, 1999, and December 28, 1999.

Company A established Plan X on April 1, 1956. Plan X is a qualified profit sharing plan under section 401(a) of the Code, and its related trust is tax-exempt under section 501 (a). Under Plan X, participants can make cash or deferred elections ("before- tax contributions") and receive matching employer contributions pursuant to Plan X's cash or deferred arrangement under section 401(k). In addition, participants may make after-tax contributions to Plan X. Company A matching contributions are made on both before- and after-tax contributions up to prescribed limits.

Plan X participants may elect to direct their contributions be invested in up to seven (7) investment funds maintained within the Plan, including Fund M which consists of Company A Common Stock. Matching contributions are invested in the same investment option as that directed for employee contributions. A participant's investment in Fund M is measured in actual shares of Company A Common Stock. A participant can direct the Trustee as to the manner in which to vote the number of shares of Company A Common Stock allocated to his account within Fund M. In addition, a participant receives dividends based on the number of shares of Company A Common Stock allocated to his account within Fund M on each dividend record date.

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Each Plan X participant and beneficiary with accounts still maintained within Plan X, can transfer their investments between Plan X investment funds, including the Fund M, on a daily basis. Because Plan X participants can transfer into or out of the Fund M on a daily basis, only those shares actually held by Plan M and allocated to a participant on the record date receive dividends. These dividends are paid to the Trustee by the dividend disbursing agent.

Effective January 10, 1997, Company A amended Plan X to provide that the portion of Plan X invested in the Fund M will constitute an "employee stock ownership plan" ("ESOP") described in section 4975(e)(7) and section 407(d) of the Employee Retirement Income Security Act of 1974 ("ERISA"). The ESOP portion is treated as a stock bonus plan which satisfies the requirements of sections 40l (a) and 4975(e)(7), and section 407(d)(6) of ERISA.

Company A Common Stock invested in the Fund M satisfies the requirements as a qualifying employer security as defined in sections 4975(e)(8) and 409(l). Each Plan X participant who had an account within Fund M of Plan X prior to the referenced amendment of Plan X will now have such account maintained within the ESOP portion of Plan X, including the account balance maintained in Fund M as of the effective date of the amendment. Participants will continue to have an opportunity on a daily basis to transfer their investments between Fund M and the other available investments under Plan X.

Plan X will provide that all cash dividends paid by Company A after the date of the amendment with respect to its Common Stock allocated to participant accounts within the ESOP will be distributable to participants and/or their beneficiaries on a quarterly basis, but in no event later than 90 days after the end of the plan year. Plan X will also provide that each participant and beneficiary may elect one of the following three distribution methods with respect to Company A Common Stock dividends: (l) elect to receive l00% of the dividend in cash; with no additional amount of compensation deferred into Plan X; (2) receive 100% of the dividend in cash and make a supplemental Plan X deferral from compensation equal to 50% of the dividend paid to the participant, pursuant to an election or deemed election; (3) elect to receive the dividend in cash in an amount equal to the maximum supplemental Plan X deferral permitted by the Code and make a supplemental Plan X deferral equal to such amount, pursuant to an actual election or deemed election. Employee participants who do not return an election form are deemed to have elected method 3.

Under method 3, dividend amounts that are not distributed because they exceed the deferral amount permitted by the Code are kept in the plan and allocated to the account of the participant.

A former employee, retiree or beneficiary with an account balance in the ESOP portion of Plan X, or an active employee who is currently suspended from making

before-tax contributions due to a previous hardship withdrawal, may elect to receive a dividend distribution. They cannot make additional contributions to Plan X.

Company A's payroll department will act as a dividend disbursing agent on behalf of the Plan X trustee ("Trustee") for those dividends that are not in excess of the deemed election amount described above. The Trustee will pay and disburse to a participant all applicable ESOP dividends, which were elected to be received by a participant.

Based on the foregoing, you request the following rulings:

1. That the dividends paid on Company A Common Stock held by the ESOP portion of Plan X on the dividend record date that are paid by the Trustee or to the payroll department, as agent of the trustee, in cash to participants within 90 days of the end of the Plan year, will be deductible by Company A in the year paid to participants under section 404(k).

2. That the additional before-tax contributions made to Plan X pursuant to the deemed election in the manner described above will not constitute wages subject to federal income tax withholding under section 3402.

3. That the dividends disbursed by the payroll department in the manner described above will not constitute wages subject to Old Age, Survivors and Disability Insurance tax or Hospital Insurance tax under sections 3101 or 3111.

4. That the dividends paid by Company A on Company A Common Stock held by the ESOP on the record date constitute applicable dividends under section 404(k) irrespective of whether a participant, subsequent to the dividend record date, sells all or a portion of the Company A Common Stock held in his or her account within the ESOP portion of the Plan and transfers the proceeds to other permitted investments within Plan X, as long as such dividend is paid to the participant no later than 90 days after the end of the Plan Year

We are unable to respond to your fifth ruling request, because section 6.03 of Revenue Procedure 99-4, 1999-1 I.R.B. 115 states that the National Office does not issue a letter ruling on matters involving a plan's qualified status under sections 401 through 420 and 4975(e)(7) of the Code. The facts presented, in this request raise the issue of whether Plan X is qualified under the applicable sections of the Code. Therefore, we are unable to issue a ruling to you at this time.

Section 404(k)(1) 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 an 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)(5)(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.

Accordingly, we conclude with respect to your first ruling request that cash dividends on shares of Company A common stock will be deductible in the year distributed or paid under section 404(k) of the Code, if such dividends are paid directly to participants (or their beneficiaries) or by the trustee as its agent, no later than 90 days after the close of the plan year in which the dividends are paid to Plan X. We also conclude with respect to your fourth ruling request that the dividends paid by Company A on Company A Common Stock held by the ESOP on the record date constitute applicable dividends under section 404(k) irrespective of whether a participant, subsequent to the dividend record date, sells all or a portion of the Company A Common Stock held in his or her account within the ESOP portion of the Plan and transfers the proceeds to other permitted investments within Plan X, as long as such dividend is paid to the participant no later than 90 days after the end of the Plan Year

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)-1(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)-1(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)-1(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(f), 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 includible in an employee's gross income at the time the cash or other taxable amounts would have been includible in the employee's gross income (but for the cash or deferred election), nor at the time the elective contributions are contributed to the plan.

Federal income 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 section 501(a) as an organization described in section 401(a). Additional amounts that are deferred into the plan as a result of an actual election or deemed election as 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 defers current compensation in an amount equal to the ESOP dividends distributed to the participant, under the procedures described above, the amounts so deferred will not constitute wages subject to income tax withholding under section 3402 of the Code.

With respect to your third ruling request, section 3102 of the Code requires employers to withhold the tax imposed by section 3101, that is, the employee portion of tax under the Federal Insurance Contributions Act (FICA), from wages as defined in section 3121(a). Similarly, section 3111 requires the employer to pay the employer portion of the FICA tax on wages as defined in section 3121(a).

Under section 3121(a) of the Code, "wages" generally means all remuneration for employment.

The dividends paid on common stock held in Plan X's common stock fund to Plan X by Company A and distributed to participants in cash are not remuneration for services or remuneration for employment. While section 404(k) of the Code allows a deduction for dividends paid in cash, that section does not cause them to be remuneration for services or remuneration for employment. Thus, they are not wages and are not subject to FICA tax.

The above rulings are based on the assumption that Plan X will be qualified under sections 401(a), 401(k), 409, and 4975(e)(7) of the Code, and the related trust 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' accounts in Plan X are "applicable employer securities", within the meaning of section 404(k)(3) with respect to the subject dividends.

In addition, this ruling is 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.

This ruling is also based on the assumption that ESOP Dividends received on Company A stock will be distributed to all Plan X participants in a manner that does not discriminate among Plan X participants and will not cause the trustee of Plan X to violate the fiduciary requirements of Title I of the Employee Retirement Income Security Act of 1974.

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.

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,

Frances V. Sloan

Frances V. Sloan, Manager
Employee Plans, Technical Group 3
Tax Exempt and Government Entities

Division

Enclosures:
Deleted Copy of Letter
Notice of Intention to Disclose

CC:

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