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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

MAY 2 2 2007

T:EP:RA:T3

LEGEND:

Company A:

Plan X:

Plan Y:

Dear

This letter is in response to a request for a ruling letter submitted on your behalf by your authorized representative on December 28, 2005, as supplemented by letters dated November 20, 2006, and January 2, 2007, and other correspondence dated January 9, 2007, concerning the prepayment of an exempt loan upon termination of an employee stock ownership plan ("ESOP"). Your authorized representative has submitted the following facts and representations in support of this request.

Company A, a C corporation, is a financial holding company. Company A established Plan X, a leveraged ESOP, effective May 15, 2002, for the benefit of its employees and its subsidiaries' employees. Company A also sponsors Plan Y, which is a plan with a cash or deferred arrangement as described in section 401(k) of the Internal Revenue Code ("Code") and is intended to be qualified under Code section 401(a).

Plan X consists of its participants' Company A stock accounts and a suspense account, further described below. Plan X is intended to be qualified under Code section 401(a) and to meet the requirements of Code section 4975(e)(7). In connection with the establishment of Plan X, the trustees of Plan X's related trust borrowed approximately $ from Company A (the "ESOP Loan"). The ESOP Loan was intended to be an exempt loan as described in Code section 4975(d)(3). In 2002, Plan X used the proceeds of the ESOP Loan to purchase shares of Company A common stock. The ESOP Loan is secured with a continuing security

interest in the shares of Company A stock held in the ESOP Loan suspense account ("Suspense Account"). At the time that Plan X was established and at the time the ESOP Loan was entered into, Company A contemplated and fully intended that Plan X would continue beyond the repayment of the ESOP Loan and the allocation to Plan X participants' Company A stock accounts of all of the shares of Company A stock held in the Suspense Account. Company A has made substantial, recurring and consistent contributions to Plan X, resulting in significant payment of the ESOP Loan.

Since its organization in Company A sought to expand the business of its principal operating subsidiary, which offers a broad range of banking and related services, by means of acquiring existing banks. After one such acquisition in 2002, Company A discovered various unauthorized loans made in violation of the subsidiary's lending policies and procedures. These loans resulted in $ of losses. These losses, together with certain other loan losses, resulted in a net loss of $ for Company A for 2002. In 2003, the level of nonperforming and charged-off loans also resulted in a significant ($) provision for loan losses. For 2004, Company A's net income was 90 percent less than net income for 2003. Company A and its principal subsidiary now have a new senior management team which has determined that it must reduce costs, among other objectives, and has recommended the cessation of Plan X's funding.

As a result of these substantial business challenges, Company A proposes to terminate Plan X in 2005 for financial and business reasons. Upon the termination of Plan X, Company A will redeem the number of Company A shares held in the Suspense Account that are equal in value (as determined on the date of such redemption using market quotations) to the then outstanding balance of the ESOP Loan, plus accrued interest. The trustees of Plan X will simultaneously use the redemption proceeds to repay the then outstanding balance of the ESOP Loan, plus accrued interest. The remaining shares in the Suspense Account, which are estimated to be approximately (assuming the redemption occurred on January 1, 2006), will then be allocated as earnings to the Company A stock accounts of Plan X participants in the same proportion that each Plan X participant's compensation for the prior plan year bears to the total compensation of all Plan X participants for such prior plan year. After receipt of a favorable determination letter from the Service on the termination of Plan X, the balances credited to participants' Company A stock accounts in Plan X will be transferred to the trustees of Plan Y. Your authorized representative has represented that the transfers from Plan X to Plan Y will be in compliance with Code section 414(l).

Your authorized representative has requested rulings to the effect of the following on your behalf:

1. Plan X's repayment of the ESOP Loan , plus accrued interest, in connection with the termination of Plan X, with the proceeds of the proposed stock redemption by Company A of unallocated shares held in the Suspense Account (equal in value to the outstanding balance of the ESOP Loan, plus accrued interest, at the time of such redemption), will not violate the exempt loan requirements under 4975(d)(3) of the Code or section 54.4975-7(b) of the regulations, and will not, therefore, constitute a prohibited transaction under section 4975 of the Code;

2. The allocation to Plan X participants' Company A stock accounts of surplus shares of Company A common stock remaining in the Plan X suspense account immediately following the repayment of the ESOP Loan, plus accrued interest, are treated as earnings and not as annual additions for purposes of Code section 415(c);

3. The amounts representing the transfers from Plan X to Plan Y of each participant's Company A stock account will not, pursuant to Code section 402, constitute distributions which would be taxable to the participants in the year of such transfer; and

4. The amounts representing the transfers from Plan X to Plan Y of each participant's Company A stock account will not constitute an "annual addition" within the meaning of Code section 415(c)(2), for purposes of determining limitations for defined contribution plans by Plan Y.

With respect to your first requested ruling, an ESOP is designed to invest primarily in employer securities. An ESOP must be part of a stock bonus plan qualified under section 401(a) of the Code, or a stock bonus plan in a money purchase plan qualified under section 401(a). A leveraged ESOP borrows funds which it uses to purchase employer securities, usually from the employer. The ESOP loan or loans are generally from the employer or guaranteed by the employer. The acquired employer securities are held in a suspense account pending allocation to the accounts of plan participants in accordance with the rules of section 54.4975-11(d) of the Excise Tax Regulations ("regulations"). An ESOP generally uses employer contributions to the plan and cash dividends on employer stock held by the plan to repay the exempt loan.

Under section 4975(d)(3)(A) of the Code, an ESOP loan generally is exempt from the prohibitions provided in section 4975(c) and the excise taxes imposed by sections 4975(a) and (b) only if the loan is primarily for the benefit of the participants and beneficiaries of the plan ("primary benefit requirement"). Section 54.4975-7(b)(3) of the regulations provides that all of the surrounding facts and circumstances will be considered in determining whether an ESOP loan satisfies the primary benefit requirement. Among the relevant facts and circumstances are whether the transaction promotes employee ownership of the employer stock, whether contributions to the ESOP are recurring and substantial, and the extent to which the method of repayment of the loan benefits the employees. All aspects of the loan transaction, including the method of repayment, will be scrutinized to determine whether the primary benefit requirement is satisfied.

Section 54.4975-7(b) of the regulations indicates that the employer has the primary responsibility for the repayment of an exempt loan through contributions to the plan. Section 54.4975-7(b)(6) provides for the repayment of an exempt loan in the event of default. However, the exemption provided by section 4975(d)(3) of the Code, and described in the associated regulations, will not fail to be met merely because the trustee sells the unallocated suspense account shares and uses the proceeds to repay the exempt loan, if the transaction satisfies the primary benefit requirement based on all the surrounding facts and circumstances.

Section 54.4975-7(b)(5) of the regulations also provides that the only assets of an ESOP that may be given as collateral on an exempt loan are qualifying employer securities of two classes: those acquired with the proceeds of the loan and those that were used as collateral on a prior exempt loan repaid with the proceeds of the current exempt loan. 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.

Section 54.4975-7(b)(5) of the regulations does not establish a per se prohibition against exempt loan prepayment by an ESOP. However, as noted above, if an ESOP contemplates prepaying an exempt loan, the funds used to prepay the loan must be limited as described in this regulation.

In this case, Company A has made consistent and substantial contributions to Plan X for repayment of the ESOP Loan. At the time Plan X was established and at the time the ESOP Loan occurred, Company A intended that Plan X would continue until the ESOP Loan was repaid and all shares of common stock held in the suspense account were allocated to participants. However, Company A decided to terminate Plan X for the financial and business reasons described above. Upon the termination of Plan X, Company A will redeem the number of Company A shares held in the Plan X suspense account that are equal in value (as determined on the date of such redemption using market quotations) to the then outstanding balance of the ESOP Loan, plus accrued interest. The trustees of Plan X will simultaneously use the redemption proceeds to repay the then outstanding balance of the ESOP Loan, plus accrued interest. The remaining shares in Plan X's suspense account, which are estimated to be approximately (assuming the redemption occurred on January 1, 2006), will then be allocated as earnings to the Company A stock accounts of Plan X participants in the same proportion that each Plan X participant's compensation for the prior plan year bears to the total compensation of all Plan X participants for such prior plan year.

Accordingly, with respect to your first requested ruling, we conclude that Plan X's repayment of the ESOP Loan , plus accrued interest, in connection with the termination of Plan X, with the proceeds of the proposed stock redemption by Company A of unallocated shares held in the Suspense Account (equal in value to the outstanding balance of the ESOP Loan, plus accrued interest, at the time of such redemption), will not violate the exempt loan requirements under 4975 (d)(3) of the Code or section 54.4975-7(b) of the regulations, and will not, therefore, constitute a prohibited transaction under section 4975 of the Code.

With respect to your second requested ruling, section 415(a)(1)(B) of the Code provides that contributions and other additions under a defined contribution plan (including an ESOP) with respect to a participant for any taxable year may not exceed the limits of subsection (c). Section 415(c)(1) of the Code states that contributions and other additions with respect to a participant exceed the limitation of this subsection if, when expressed as an "annual addition" to the participant's account, such annual addition is greater than the lesser of $40,000 or 100 percent of the participant's compensation. Section 415(c)(2) generally 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 forth special rules for ESOPs. Section 1.415-6(g)(5) provides, in part, that for purposes of applying the limitations of section 415(c) of the Code and section 1.415-6(g) of the regulations to an ESOP to which an exempt loan has been made, 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 1.415-6(b)(2)(i) of the Income Tax Regulations provides in part that the Commissioner may, in appropriate cases, considering all of the facts and circumstances, treat transactions between the plan and the employer as giving rise to annual additions.

In the present case, the shares remaining in Plan X's suspense account following the prepayment of the ESOP Loan remain there because it was not necessary to redeem them to prepay the ESOP Loan. Thus, they reflect the extent of the appreciation in the value of the shares held in the suspense account and are, in effect, earnings, and are properly treated as such as part of the termination of Plan X. Since the shares remaining in Plan X's suspense account are treated as earnings, they do not constitute annual additions under section 1.415-6(b)(2)(i) of the Income Tax Regulations upon their allocation to participants' accounts in this situation.

Accordingly, we conclude with respect to your second requested ruling that the allocation to Plan X participants' Company A stock accounts of surplus shares of Company A common stock remaining in the Plan X suspense account immediately following the repayment of the ESOP Loan, plus accrued interest, may be treated as earnings and not as annual additions for purposes of Code section 415(c).

With respect to your third requested ruling, Code section 402(a) provides in general that any amount actually distributed to any distributee by any employees' trust described in section 401(a) which is exempt from tax under section 502(a) shall be taxable to the distributee, in the taxable year of the distributee in which distributed, under section 72 (relating to annuities).

Revenue Ruling 67-213, 1967-2 C.B. 149, involves the transfer of funds directly from the trust forming part of a qualified stock bonus plan. The revenue ruling provides, in part, that if a participant's interest in a qualified plan is transferred from the trust forming part of that plan to the trust forming part of another qualified plan without being made available to the participant, no taxable income will be recognized by reason of such transfer.

In the present case, after receipt of a favorable determination letter on the termination of Plan X, the trustee of Plan X will directly transfer the balances credited to the Company A stock accounts of Plan X participants to the trustees of Plan Y.

Accordingly, we conclude with respect to your third requested ruling that the amounts representing the transfers from Plan X to Plan Y of each participant's Company A stock account will not, pursuant to Code section 402, constitute distributions which would be taxable to the participants in the year of such transfer.

With respect to your fourth requested ruling, Code section 415(a)(1)(B) provides that a defined contribution plan is not a qualified plan if contributions and other additions made to the plan with respect to any participant in a taxable year exceed the limitation of section 415(c).

Code section 415(c)(1) provides in general that contributions and other additions with respect to a participant exceed the limitation of this subsection if, when expressed as an annual addition (within the meaning of paragraph (2)) to the participant's account such annual addition is greater than the lesser of $40,000, or 100 percent of the participant's compensation.

Code section 415(c)(2) provides in pertinent part that the term "annual addition" means the sum for any year of employer contributions, employee contributions, and forfeitures.

Section 1.415-6(b)(2)(iv) of the Income Tax Regulations states that the transfer of funds from one qualified plan to another will not be considered an annual addition for the limitation year in which the transfer occurs.

Accordingly, we conclude with respect to your fourth requested ruling that the amounts representing the transfers from Plan X to Plan Y of each participant's Company A stock account will not constitute an "annual addition" within the meaning of Code section 415(c)(2), for purposes of determining limitations for defined contribution plans by Plan Y.

This ruling letter is based on the assumption that Plan X and Plan Y are qualified under Code section 401(a) at all times relevant to the transaction described herein, and that Plan X is an ESOP as described in section 4975(e)(7). This ruling letter is also based on the assumptions that the cash or deferred arrangement contained in Plan Y is a cash or deferred arrangement as described in section 401(k) of the Code, and that no section 404(k) deduction will be taken with regard to this transaction.

We note that the Department of Labor has jurisdiction with respect to the provisions of Part 4 of Title I of the Employee Retirement Income Security Act of 1974 (ERISA), including the requirement in section 404(a)(1)(A) and section 404(a)(1)(B) of ERISA that fiduciaries discharge their duties for the exclusive purpose of providing benefits to participants and their beneficiaries and in a prudent manner. Therefore, we express no opinion as to whether the subject transactions are consistent with such provisions.

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

If you have any questions, please contact
Please refer to SE:T:EP:RA:T3.

Sincerely yours,

Frances V. Sloan

Frances V. Sloan, Manager
Employee Plans Technical Group 3

Enclosures
Notice 437
Deleted copy of ruling letter

cc: