201419025

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

FEB 14 2014

Uniform Issue List: 4975.00-00

TEP:RA:T2

XXXXX
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XXXXX

Legend:

Company X: XXXXX

Company Y: XXXXX

Taxpayer: XXXXX

Plan: XXXXX

Dear XXXXX:

This letter is in response to a request for a ruling letter submitted on your behalf by your authorized representative on March 4, 2010, supplemented by correspondence dated January 21, 2011, concerning the prepayment of an exempt loan upon termination of an employee stock plan ("ESOP").

Company X established Plan, effective October 1, 1997, for the benefit of its employees. Plan is intended to be qualified under section 401(a) of the Internal Revenue Code ("Code") and to meet the requirements of section 4975(e)(7) of the Code, as an ESOP. Plan has received a determination letter.

On July 1, 1998, Taxpayer sold 1,100,000 shares of the outstanding common stock of Company X to Plan in exchange for a non-recourse note ("Note ") of $11,986,000 to be payable in 150 monthly installments of $129,994.20. The Note was

guaranteed by Company X and was intended to be an exempt loan as described in Code section 4975(d)(3). The shares acquired by Plan, as part of this transaction, were pledged as collateral for the Note and were placed in Plan's suspense account. At the time the Note was entered into, Company X intended that Plan would continue beyond the repayment of the Note and that all of the stock in Plan's suspense account would be allocated to participants' accounts.

Company X made all of the payments required under the Note from July 1998 through January 2008. On or about December 26, 2007, Company X entered into a contract for the sale of its assets to Company Y. The contract required Company X to terminate Plan. Plan was terminated on February 1, 2008.

At the time of the termination of Plan, 851,028 shares of Company X stock had been allocated to participants and 248,972 shares of Company X stock remained unallocated in Company X's suspense account. The remaining balance on the Note was approximately $4,218,000 and the fair market value of the stock was established at $5.28 per share.

On November 4, 2008, pursuant to the agreement between Company X and Company Y to terminate Plan, Plan transferred the unallocated shares of Company X stock to Taxpayer in consideration of the Note with a purchase price of $6.52 per share of common stock.

Based on the above facts and representations, your authorized representatives request the following rulings on your behalf:

1. The prepayment of the Note as a result of the sale of Plan's unallocated stock and resulting termination of Plan, is not in violation of section 4975(d)(3) of the Code.
2. The transfer of Plan's unallocated shares to Taxpayer in satisfaction of the Note, upon termination of Plan is not a prohibited transaction under section 4975 of the Code.

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. 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.

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 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 of the plan.

Section 54.4975-(7)(b)(6) of the Regulations 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 associated regulations, will not fail to be met merely because the trustee sells the unallocated suspense account shares and uses the proceeds to repay an exempt loan, if the transaction satisfies the primary benefit requirement based upon all of 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 X has made consistent and substantial contributions to Plan from its inception in 1997 until its termination in 2008. Of the 1,100,000 shares of stock acquired by Plan with the Note, 851,028 were allocated to participants. At the time Plan was established and at the time the Note was entered into, Company X intended

that Plan would continue at least until the Note was repaid and all shares of common stock held in the suspense account were allocated to participants. However, as a result of Company X's contractual agreement with Company Y, Company X was required to terminate Plan.

The facts and circumstances surrounding the transfer of Company X stock to Taxpayer in consideration of the Note satisfy the requirements of section 4975(d)(3)(A).

Accordingly with respect to your requested rulings, we conclude that:

1. The prepayment of the Note as a result of the sale of Company X assets and resulting termination of Plan is not in violation of section 4975(d)(3) of the Code; and
2. The transfer of the unallocated shares in Plan to Taxpayer in satisfaction of the Note upon termination of Plan is not a prohibited transaction under section 4975 of the Code.

This ruling is based on the assumption that Plan is qualified under Code section 401(a), at all times relevant to the transaction described herein and that it is an ESOP as described in section 4975(e)(7).

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 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 XXXXXXXXXXX (ID# XXXXXXXXX) at XXX-XXX-XXXX. Please refer to SE:T:EP:RA:T2.

Sincerely yours,

Jason E. Levine, Manager
Employee Plans, Technical Group 2

Enclosures: Notice 437
Deleted copy of ruling letter

cc: XXXXX
XXXXX
XXXXX