Significant Index Number 415.02-05

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

201424030

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

SE:T:EP:RA:T:A2

MAR 20 2014

Re:

Taxpayer =

$X =

$Y =

$Z =

Dear :

This is in response to a request for a private letter ruling dated February 11, 2013, as supplemented by correspondence dated November 5, 2013, submitted by your authorized representative. Your request involves the applicability of section 415(c) of the Internal Revenue Code ("the Code") to certain contributions to an employee stock ownership plan ("ESOP"). Your authorized representative has submitted the following facts and representations in support of this request.

Facts and Representations

The Taxpayer elected to be treated as an S corporation for federal income tax purposes, effective as of June 1, 1989. The Taxpayer files its income tax returns on IRS Form 1120S and an annual return for the ESOP on Form 5500 on a calendar year basis in both cases. Effective as of January 1, 1994, the Taxpayer established the Plan, an ESOP, as described in section 4975(e)(7) of the Code.

The Taxpayer has been profitable every year since its founding; it is well managed and operates with a high degree of efficiency. Employee turnover is low. Although the Taxpayer is relatively small it has consistently generated more cash flow than is required for the Plan to purchase 100 percent of the Taxpayer's stock and satisfy its repurchase obligations under the Plan.

The Plan was last amended and restated effective January 1, 2012. The Plan's related Trust is exempt from tax under section 501(a) of the Code. The most recent IRS determination letter applies to the Plan as amended and restated effective January 1, 2007.

From 1998 through 2009 the Plan purchased the Taxpayer's shares in 9 transactions from the Taxpayer's sole shareholder. In the last of these transactions, the remaining shares held by this shareholder were purchased by the Plan using the proceeds of a loan exempt under section 4975(d)(3) of the Code. This exempt loan was fully repaid as of December 31, 2012. As a result, the Plan now owns 100% of the Taxpayer, with all of the Taxpayer's shares allocated to the accounts of the Plan's participants. The Taxpayer's stock held in the Plan constitutes all of the Taxpayer's stock issued and outstanding.

The Taxpayer's business does not incur significant capital expenditures or require significant cash reserves in relation to its earnings. As of December 31, 2012, the Taxpayer had $X of cash on hand, of which the Taxpayer's Board of Directors (the "Board") has determined approximately $Y is necessary for the reasonable needs of the Taxpayer's business.

The Board has determined that it would not be in the interest of the Taxpayer to retain cash that far exceeds the reasonable needs of the business. As a consequence, the Taxpayer proposes to make S corporation distributions (as described in section 1368(a) of the Code) of $Z to the Plan, (an amount which will not exceed the Taxpayer's accumulated adjustments account as described in section 1368(e)(1) of the Code) allowing the Taxpayer to retain as cash on hand an amount that is necessary to meet its reasonable business needs.

The distribution would be allocated to the participants of the Plan based on the number of shares of Taxpayer stock allocated to each participant on the record date for the distribution.

Requested Ruling

A ruling has been requested that no part of the proposed S corporation distributions with respect to the Taxpayer stock will constitute or be treated as an "annual addition," as described in section 415(c)(2) of the Code, to accounts of participants of the Plan.

Applicable Law

Section 401(a) of the Code 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.

Section 415(a) of the Code provides, in pertinent part, that a trust which is part of a pension, profit-sharing, or stock bonus plan will not constitute a qualified trust under section 401(a) of the Code if, in the case of a defined contribution plan, contributions and other additions under the plan with respect to any participant for any taxable year exceed the limitation of subsection 415(c) of the Code.

Section 415(c)(1) of the Code provides that contributions and other additions with respect to a participant exceed the limitations of this subsection if, when expressed as an annual addition (as defined below), such annual addition is greater than the lesser of (A) $40,000, or (B) 100 percent of the participant's compensation.

Section 415(d) of the Code provides for cost-of-living adjustments to certain limitations described in section 415 of the Code. Accordingly the limitation under section 415(c)(1)(A) currently stands at $52,000 for limitation years ending in 2014.

Section 415(c)(2) of the Code defines an "annual addition" as the sum for any year of employer contributions, employee contributions, and forfeitures.

Section 4975(e)(7) of the Code 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 qualified under Code section 401(a), and which are designed to invest primarily in qualifying employer securities.

Section 1.415(c)-1(b)(4) of the Income Tax Regulations (the "regulations") provides that the Commissioner may, in appropriate cases, considering all of the facts and circumstances, treat transactions between the plan and the employer or certain allocations to participant accounts as giving rise to annual additions.

<u>Analysis and Conclusion</u>

The facts and circumstances of the present case do not support the recharacterization of these S corporation distributions as annual additions under the authority of section 1.415(c)-1(b)(4) of the regulations. Instead these amounts constitute distributions of earnings to the Taxpayer's shareholders and not contributions or other additions with respect to participants of the ESOP.

Therefore the proposed S corporation distributions to the ESOP are not employer contributions, employee contributions, or forfeitures, and hence do not fall within the definition of annual additions as defined in section 415(c)(2) of the Code.

Accordingly, we conclude with respect to your requested ruling that the proposed S corporation distributions made by the Taxpayer with regard to the Taxpayer's stock held in the Plan's participant accounts will not constitute "annual additions" within the meaning of section 415(c)(2) of the Code.

This ruling assumes that the Plan is qualified under section 401(a) of the Code, and its related trust exempt from taxation under section 501(a) of the Code, at all times relevant to this transaction. It also assumes that the Plan meets the requirements of section 4975(e)(7) of the Code.

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

We have sent a copy of this letter to your authorized representatives pursuant to a power of attorney (Form 2848) on file in this office. If you have any questions regarding this matter, please contact at .

Sincerely yours,

David M. Ziegler, Manager
Employee Plans Actuarial Group 2

cc: