Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:EEE:EB:QP1
PLR-129901-18

Date:
August 08, 2019

In Re:

LEGEND

Company =
Plan =
Trust =
Debt =
Year 1 =

Dear :

This letter responds to your request dated September 10, 2018, as supplemented by correspondence dated December 20, 2018 and July 31, 2019, submitted on your behalf by your authorized representative, requesting a private letter ruling on whether the proposed transactions described below will give rise to tax-deductible contributions as provided under Section 404 of the Internal Revenue Code of 1986, as amended (the "Code").

FACTS

You and your authorized representative represented the following facts under penalty of perjury in your letter of Date 1:

> The Company provides insurance products and financial services, and uses a calendar year accounting period and the accrual method of accounting for federal income tax purposes.
>
> The Company maintains the Plan for the benefit of its employees. The Plan is a single-employer, defined benefit pension plan that meets the qualification requirements of section 401(a) and holds assets in a qualified trust that meets

the requirements of section 501(a). The Plan uses a calendar year plan year. The assets of the Plan are held in the Trust.

The Debt is various investment-grade debt securities issued by the Company that are readily traded on an established securities market. The Company intends to acquire the Debt in the market, and then contribute it to the Trust. The Debt will have an interest rate greater than the long-term applicable Federal rate in effect on the date of contribution and will not have any unusual or atypical features such as embedded options or conversion features. Prior to redemption, only interest payments will be made with respect to the Debt, and, at maturity, the entire principal will be repaid. The Debt can be redeemed early by lump-sum payment. This lump sum payment is calculated as the present value of the sum of the principal amount and the remaining interest coupon payments, discounted at the interest rate for the US Treasury security having a maturity comparable to the remaining term of the security being redeemed plus an adjustment of between 25 and 50 basis points. Further, in the final 3-6 months prior to the maturity of the Debt, the Debt can be redeemed at 100% of principal immediately pursuant to a cleanup call.

Once held by the Plan, there are no restrictions or conditions on what the trustee of the Trust may do with the Debt; the trustee may sell or otherwise transfer all or part of the debt securities. The Company will make payments in cash in accordance with the terms of the Debt. Accordingly, in addition to interest payments, the Plan will receive cash (or a cash equivalent) on the Debt when principal payments are made on the Debt; if the Debt is redeemed by the Company (which could be done at a date prior to maturity); or if the Debt is transferred from the Trust to a third party for consideration.

The Debt will satisfy the requirements to be treated as a "marketable obligation" under Section 407(e) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). It is intended that the contribution of the Debt would not constitute a prohibited transaction by reason of satisfying the exemption for a plan's acquisition of "qualifying employer securities."[1]

RULINGS REQUESTED

You have requested that we issue the following rulings:[2]

1. Upon payment of principal in cash by the Company pursuant to the terms of the Debt, whether at maturity, in prepayment or in repurchase of the Debt by the

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[1] This ruling does not express an opinion on whether the transaction constitutes a prohibited transaction. Whether a transaction is a prohibited transaction is within the jurisdiction of the Department of Labor.
[2] You have stated that no ruling is requested with respect to the deductibility of interest payments on the Debt.

Company pursuant to the right of early redemption, the payment (or prepayment) is deductible by the Company in the taxable year in which it is made (or deemed to be made pursuant to section 404(a)(6)), subject to the limits of section 404(o).

2. The cash (or cash equivalent) proceeds received by the Plan from a transfer or sale of the Debt to a party not in a controlled group with the Company or otherwise affiliated with the Company pursuant to sections 414(b), (c), (m) and (o), will be treated as a contribution by the Company to the Trust, and the amount of the contribution (equal to the amount of the transfer proceeds) is deductible by the Company in the taxable year in which the transfer is made (or deemed to be made pursuant to section 404(a)(6)), subject to the limits of section 404(o).

LAW

Chapter 1 of Subtitle A of the Code permits an employer to deduct certain expenses from income for a taxable year. For example, section 162(a) permits an employer to claim a deduction on its federal income tax return for a taxable year for ordinary and necessary expenses, such as compensation, paid or incurred during that taxable year in carrying on the employer’s trade or business.

Section 404 provides rules regarding the deductibility of deferred compensation, including employer contributions made to the trust of a defined benefit pension plan that is qualified under section 401(a). Pursuant to section 404(a), if contributions are paid by an employer to the trust of a pension plan, then those contributions are not deductible under section 162 or any other provision of Chapter 1 of Subtitle A. Instead, employer contributions made to the pension trust are deductible under section 404, subject to the limits set forth in section 404(a) as to the amounts deductible in any year, but only if they would otherwise be deductible under section 162 or another provision of Chapter 1 of Subtitle A. See also section 1.162-10(a) of the Income Tax Regulations.

Section 404(a)(1) provides rules regarding the deductibility of contributions with respect to a qualified pension plan. Pursuant to section 404(a)(1)(A), contributions paid by an employer to the trust of a qualified defined benefit pension plan are deductible in the employer’s taxable year when paid if that taxable year ends within or with a taxable year of the trust, subject to the applicable limits.

Section 404(a)(6) provides that, for purposes of section 404(a)(1), a taxpayer is deemed to have made a payment on the last day of the preceding taxable year if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for that taxable year (including extensions).

Section 1.404(a)-1(c) provides, “Deductions under section 404(a) are generally allowable only for the year in which the contribution is paid, regardless of the fact that the taxpayer may make his returns on the accrual method of accounting. Exceptions

are made… as provided by section 404(a)(6), in the case of payments made by a taxpayer on the accrual method of accounting not later than the time prescribed by law for filing the return for the taxable year of accrual (including extensions thereof). This latter provision is intended to permit a taxpayer on the accrual method to deduct such accrued contribution or compensation in the year of accrual, provided payment is actually made not later than the time prescribed by law for filing the return for the taxable year of accrual (including extensions thereof)."

Section 404(o) provides the deductible limit for contributions with respect to a single-employer defined benefit pension plan. In the case of such a plan, section 404(o)(1) provides that the deductible limit for any taxable year is equal to the greater of: (A) the sum of the amounts determined under section 404(o)(2) with respect to each plan year ending with or within the taxable year, or (B) the sum of the minimum required contributions under section 430 for those plan years.

The amount determined under section 404(o)(2) for any plan year is equal to the excess (if any) of (i) the sum of (I) the funding target for the plan year, (II) the target normal cost for the plan year, and (III) the cushion amount for the plan year, over (ii) the value (determined under section 430(g)(3)) of the plan's assets that are held by the plan as of the valuation date for the plan year.

Section 404(o)(7) provides that any term used in section 404(o) that is also used in section 430 shall have the same meaning as under section 430.

Section 430(c)(7)(F)(i) provides that the term "plan sponsor" includes any member of the plan sponsor's controlled group (as defined in section 412(d)(3)).

Section 412(d)(3) provides that the term "controlled group" means any group treated as a single employer under section 414(b), (c), (m) or (o).

In *Don E. Williams Co. v. Commissioner*, 429 U.S. 569 (1977), the Supreme Court held that an accrual-basis corporate taxpayer, in delivering its fully secured promissory demand note to the trustees of its qualified employees' profit-sharing trust, is not entitled to a deduction under section 404(a) for the taxable year in which the note is contributed because the note did not constitute actual payment under section 404.

The Court stated, "The statutory terms "paid" and "payment," coupled with the grace period and the legislative history's reference to "paid" and "actually paid," demonstrate that, regardless of the method of accounting, all taxpayers must pay out cash or its equivalent by the end of the grace period in order to qualify for the section 404(a) deduction. This accords, also, with the apparent policy behind the statutory provision, namely, that an objective outlay-of-assets test would insure the integrity of the employees' plan and insure the full advantage of any contribution which entitles the employer to a tax benefit." *Don E. Williams* at 578-79.

The Court further noted, “[t]he taxpayer argues that because its notes are acknowledged to have had value, it is entitled to a deduction equal to that value. It is suggested that such a note would qualify as income to a seller-recipient. Whatever the situation might be with respect to the recipient, the note, for the maker, even though fully secured, is still only his promise to pay. It does not in itself constitute an outlay of cash or other property.” Id. at 579.

ANALYSIS

Ruling Request #1

You have represented that the Company will make payments in cash in accordance with the terms of the Debt. You have further represented that the Trust will receive cash (or a cash equivalent) on the Debt when principal payments are made or if the Debt is redeemed by the Company prior to maturity.

The Debt itself is only the Company’s promise to pay and does not represent the paying out or reduction of the Company’s assets. Consequently, the contribution of the Debt securities themselves is not a contribution paid to the Trust within the meaning of section 404(a), § 1.404(a)-1(c), or *Don E. Williams*, and the Company may not claim a deduction for the contribution of the Debt for the Company’s taxable year for which the contribution is made.

However, if a payment of principal made pursuant to the terms of the Debt satisfies the objective outlay-of-assets test under *Don E. Williams*, then the payment is deductible by the Company under section 404(a) as a contribution for the taxable year in which the payment is made (or deemed to be made pursuant to section 404(a)(6), in the case of a contribution made on account of the employer’s prior taxable year), subject to the applicable limits and other requirements of section 404 and any other applicable Code provisions (such as the capitalization requirements of section 263A). This analysis applies to a payment by the Company of principal in the form of unrestricted cash (or a cash equivalent), whether upon maturity, prepayment, or repurchase, made pursuant to the terms of the Debt.

Ruling Request #2

Pursuant to section 404(a) and the objective outlay-of-assets test of *Don E. Williams*, employer contributions to the trust of a qualified plan are deductible for the employer’s taxable year ending within or with the plan year in which the contribution is actually paid (or deemed to be paid pursuant to section 404(a)(6), in the case of a contribution made on account of the employer’s prior taxable year), subject to the applicable limits.

You have represented that, once held by the Trust, there are no restrictions or conditions on what the Trust may do with the Debt and the Plan's fiduciaries may sell or otherwise transfer all or part of the Debt however they deem suitable for the Plan's purposes. You have further represented that, aside from interest payments, the Trust will receive cash (or a cash equivalent) on the Debt when the Debt is transferred at the direction of a Plan fiduciary to a third party for consideration.

You have requested that the cash (or cash equivalent) proceeds received by the Plan from a transfer or sale of the Debt to a party not in a controlled group with the Company or otherwise affiliated with the Company pursuant to sections 414(b), (c), (m) and (o) (referred to in this letter ruling as an unrelated third party) will be treated as a contribution by the Company to the Trust, and the amount of the contribution (equal to the amount of the transfer proceeds) is deductible by the Company for the taxable year in which the transfer is made (or deemed to be made pursuant to section 404(a)(6)), subject to the limits of section 404(o). This approach is consistent with the objective outlay-of-assets test which, as the Supreme Court in *Don E. Williams* explained, is intended to ensure the integrity of the employees' plan and the full advantage of any contribution that entitles the employer to a tax benefit. Here, when the Debt is transferred to an unrelated third party and that unrelated third party pays the proceeds to the Trust, the Trust will obtain the full advantage of the contribution that entitles the Company to a tax benefit.

Any cash (or cash equivalent) proceeds received by the Trust from a transfer or sale of the Debt to an unrelated third party will be treated as a contribution by the Company to the Trust for purposes of the requirement under section 404(a) that a contribution actually be paid, as determined in accordance with the objective outlay-of-assets test under *Don E. Williams*. Accordingly, such a contribution (equal to the amount of the proceeds from the transfer or sale to an unrelated third party) is deductible by the Company for the taxable year in which the transfer is made (or deemed to be made pursuant to section 404(a)(6)), subject to the applicable limits and other requirements of section 404 and any other applicable Code provisions (such as the capitalization requirements of section 263A).

Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the transaction described above under any other provision of the Code or Title 1 of ERISA.

In particular, no opinion is expressed regarding the deductibility of interest payments made pursuant to the terms of the Debt, or whether part or all of the contributions to the Trust must be capitalized under section 263A.

The rulings contained in this letter are based upon information and representations submitted by Company and accompanied by a penalty of perjury statement executed by an appropriate party, as specified in Rev. Proc. 2019-1, 2019-1 I.R.B. 1, § 7.01(16)(b).

This office has not verified any of the material submitted in support of the request for ruling, and such material is subject to verification on examination. The Associate office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based; or, in the case of a transaction involving a continuing action or series of actions, the controlling facts change during the course of the transaction. See Rev. Proc. 2019-1, § 11.05.

Pursuant to a power of attorney on file with this office, a copy of this letter ruling is being sent to your authorized representatives.

This letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Linda S. F. Marshall
Senior Counsel
Qualified Plans Branch 1
Office of the Associate Chief Counsel
(Employee Benefits, Exempt Organizations,
and Employment Taxes)

cc: