

## **Employee Stock Ownership Plan Listing of Required Modifications and Information Package (ESOP LRM)**

### **For use with Pre-approved Plans intending to satisfy the requirements of Code § 4975(e)(7)**

Revenue Procedure 2015-36 ("Rev. Proc. 2015-36") expanded the pre-approved program to cover employee stock ownership plans (ESOPs) and set forth certain requirements to be a pre-approved ESOP.

Revenue Procedure 2017-41 ("Rev. Proc. 2017-41"), modified and superseded, in part, Rev. Proc. 2015-36. Revenue Procedure 2023-37 ("Rev. Proc. 2023-37"), modifies and supersedes, in part, Rev. Proc. 2017-41. Section 4.01(20) of Rev. Proc. 2023-37 provides that a pre-approved plan that includes an ESOP cannot be a standardized plan.

Under Internal Revenue Code ("Code") § 4975(e)(7), an ESOP is a defined contribution plan that is a stock-bonus plan, or a combination of a stock bonus and a money purchase plan. However, under section 10.02(2)(d) of Rev. Proc. 2023-37, an ESOP will not be issued an opinion letter if the ESOP is a combination of a stock bonus and a money purchase plan. A pre-approved ESOP must meet the requirements of Code § 401(a), the requirements reflected in the Defined Contribution Plan Listing of Required Modifications and Information Package (DC LRM) and in this information package, the requirements set forth in the 20xx Cumulative List of Changes in Plan Qualification Requirements (Notice, as updated), and the requirements of Rev. Proc. 2023-37.

This information package contains samples of plan provisions that satisfy certain requirements of the Code applicable to ESOPs. Such language may or may not be acceptable in specific plans depending on the context in which used. To expedite the review process, plan sponsors are encouraged to use the language in this package.

A partnership or a joint venture is not eligible to maintain an ESOP. However, a partnership or a joint venture that has elected to be taxed as a corporation may be a Participating Employer as defined in ESOP LRM 3.

An ESOP cannot be integrated directly or indirectly with contributions or benefits under Title II of the Social

Security Act or any other State or Federal law. See Treas. Reg. § 54.4975-11(a)(7)(ii).

ESOPs that provide for the holding of employer stock as defined in Code § 409(l)(3) are excluded from the pre-approved program under Rev. Proc. 2023-37, section 10.02(2)(e).

The applicability of parts or all of ESOP LRM sections 8, 13, 15, 16, 17, 18 and 19 depends on whether the Employer is an S or a C corporation. Even though these sections may not be applicable because of the Employer's corporate status and thus not required, the Employer may include these sections.

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## Part I - General ESOP Requirements

### 1. Designation as ESOP

Statement of Requirement: Code § 4975(e)(7); Treas. Regs. §§ 54.4975-11(a)(2) and (5), 54.4975-11(b).

[Note to Reviewer: Under Rev. Proc. 2023-37, a pre-approved ESOP can only be a stock bonus plan; it cannot be a combination of a money purchase pension plan and a stock bonus plan. Sections 14.06 and 14.07 of Rev. Proc. 2023-37 permit a nonstandardized plan that contains an ESOP to include a Code § 401(k) feature.]

#### Sample Plan Language:

The Plan ("Plan") is an employee stock ownership plan ("ESOP") within the meaning of § 4975(e)(7) of the Internal Revenue Code of 1986, as amended (the "Code"), and is designed to invest primarily in Employer Stock.

### 2. Employee

Statement of Requirement: Rev. Proc. 2023-37, section 9.02(10).

[Note to Reviewer: See DC LRM #9 for the definition of employee, which incorporates language required under Code § 414(b), (c), (m), (n), and (o). Employees who meet this definition are treated as employees for purposes of, for example, discrimination testing and coverage. Note, however, that only Employees of the Employer or Participating Employers (see ESOP LRM 3) can participate in the Employer's ESOP because the stock of other employers who are not described in ESOP LRM 3 does not meet the requirements of Code § 409(1) with respect to those Employees. In addition, under Rev. Proc. 2023-37, section 9.02(10), leased employees (see DC LRM 9 and 10) are not eligible to participate in a pre-approved ESOP unless they are employed by the employer corporation who issues the stock held by the ESOP or by any corporation that is a member of the same controlled group of corporations as the employer corporation (within the meaning of § 1563(a), as modified by § 409(1)(4)(B) and (C) and as determined without regard to § 1563(a)(4) and 1563(e)(3)(C).]

**Sample Plan Language to be added to DC LRM 18:** For purposes of this provision, only employees of the Employer or a Participating Employer are eligible to participate in the plan.

### **3. Employer, Participating Employer, and Corporate Status**

**Statement of Requirement:** Code §§ 409(1)(4) and 1563(a).

[Note to Reviewer: A partnership or a joint venture is not eligible to maintain an ESOP. However, a partnership or a joint venture that has elected to be taxed as a corporation may be a Participating Employer as defined in this ESOP LRM 3.]

#### **Sample Plan Language:**

“Employer” means the company as stated in the Adoption Agreement that has adopted the Plan.

“Participating Employer” means any corporation that both (1) agrees to participate in the Plan, and (2) is a member of the same controlled group of corporations as the Employer within the meaning of Code § 1563(a) (as modified by subparagraphs (B) and (C) of Code § 409(1)(4) and as determined without regard to § 1563(a)(4) and 1563(e)(3)(C)).

#### **Sample Adoption Agreement Language:**

The Employer is \_\_\_\_\_ [add the name of the company (cannot be a joint venture or a partnership) that is adopting the Plan].

The Employer is a(n)

C corporation

S corporation

### **4. Employer Stock**

**Statement of Requirement:** Code §§ 4975(e)(7) and (8), 409(1)(1) and (2); Rev. Proc. 2023-37, sections 9.04(2) and 10.02(2)(e).

[Note to Reviewer:

Under Rev. Proc. 2023-37, section 9.04(2), Employer Stock must be defined in accordance with § 409(1)(1) or (2). Under Rev. Proc. 2023-37, section 10.02(2)(e), no opinion letter will be issued for an ESOP that provides for the holding of preferred employer stock.]

**Sample Plan Language:**

Employer Stock means common stock issued by the Employer that is readily tradable on an established securities market. If there is no such common stock, then Employer Stock means common stock issued by the Employer that has a combination of voting power and dividend rights equal to or in excess of: (A) that class of common stock of the Employer having the greatest voting power, and (B) that class of common stock of the Employer having the greatest dividend rights. For purposes of this paragraph, "Employer" includes a corporation that is a member of the same controlled group within the meaning of Code § 409(1)(4).

## **5. Diversification Rights of Qualified Participants**

**Statement of Requirement: Code §§ 401(a)(28)(B) and 401(a)(35)(E)(ii); Notice 88-56, 1988-1 C.B. 540 and Notice 2013-17, 2013 I.R.B. 2013-20.**

[Note to Reviewer: A plan may allow qualified participants to choose among all of the diversification methods described below. In addition, a plan may provide one or more specified percentages for diversification, as long as one of those percentages is 25.

The plan may provide that the number of shares resulting from the calculation described in the sample plan language below will be rounded to the nearest whole integer.

A plan must use DC LRM 70A, instead of this ESOP LRM 5, if both (1) the plan is an applicable defined contribution plan, as defined in Code § 401(a)(35)(E), which includes certain plans treated as holding publicly traded employer securities pursuant to Code § 401(a)(35)(F), and (2) either the plan holds amounts subject to Code § 401(k) or (m), or the plan is not a separate plan for purposes of Code § 414(1) with respect to any other defined contribution or defined benefit plan maintained by the same employer(s).

If a plan that satisfies the diversification requirements of

Code § 401(a)(28)(B) by distributing a portion of the participant's account (as provided by this ESOP LRM 5) subsequently becomes subject to the requirements of Code § 401(a)(35), the required plan amendment to eliminate that distribution option will not cause the plan to violate IRC § 411(d)(6) provided the amendment complies with the requirements of Notice 2013-17.]

### Sample Plan Language

#### Diversification Rights of Qualified Participants

During each Annual Election Period in the Qualified Election Period, a Qualified Participant may elect to direct the Plan as to the investment of at least 25 percent of the participant's account in the Plan to the extent such portion exceeds the amount to which a prior election under this paragraph applies (the "Diversification Election").

In the year in which the participant can make his or her last election, "50 percent" is substituted for "25 percent" in the preceding sentence.

The portion of a Qualified Participant's Plan account that is diversified pursuant to a Diversification Election cannot be reinvested in Employer Stock, other than at the Participant's election.

Shares of Employer Stock that a Qualified Participant directs the Plan to diversify (the "Diversification Shares") will be diversified by one of the following methods, as selected by the Employer in the Adoption Agreement:

(a) Distributing either the Diversification Shares, or an amount equal to the value of these shares, to the Qualified Participant. The distribution must occur within 90 days after the last day of the Annual Election Period. Distributions of Diversification Shares must comply with section \_\_\_\_\_ of the Plan.

**[Note to Reviewer: Add the plan section that corresponds to ESOP LRM 9. Distributions made in accordance with a diversification election are subject to the put option rights, but not the right to demand employer securities. See Notice 88- 56, Q&A 14.]**

(b) Investing an amount equal to the value of the Diversification Shares in one or more of at least three alternative investment options available under the Plan, as

directed by the Qualified Participant. Each of these investment options must be diversified and have materially different risk and return characteristics. The Plan must invest the value of the Diversification Shares in accordance with the direction of the Qualified Participant within 90 days after the last day of the Annual Election Period.

(c) Transferring an amount equal to the value of the Diversification Shares to another qualified defined contribution plan of the Employer that offers at least three investment options (each of which must be diversified and have materially different risk and return characteristics). This transfer must be made within 90 days after the last day of the Annual Election Period and must comply with applicable qualification requirements, including Code §§ 414(1), 411(d)(6) and 401(a)(11).

#### Definitions

(a) "Annual Election Period" means the 90-day period following the end of each Plan Year in the Qualified Election Period.

**[Note to Reviewer: The Annual Election Period must begin on the first day following the end of each plan year in the Qualified Election Period, but the plan may provide that the Annual Election Period ends later than the 90<sup>th</sup> day following the end of each plan year in the Qualified Election Period, provided that the plan provides a definite date or period when the election period ends. For example, a plan may provide that the Annual Election Period begins the day after the end of each plan year in the Qualified Election Period and ends 90 days after the date that the value of the shares subject to the diversification election is provided to the participant.]**

(b) "Qualified Election Period" means the 6-Plan-Year period beginning with the first Plan Year in which the individual becomes a Qualified Participant.

(c) "Qualified Participant" means a Participant who has completed at least 10 years of participation in the Plan and has attained age 55. Years of participation are measured from the date on which the individual becomes a Participant in the Plan (whether or not the Plan was an ESOP) or a predecessor plan until the date on which the Participant ceases to be entitled to any benefit under the Plan. For this purpose, a predecessor plan includes any ESOP maintained by the Employer

or a predecessor employer within the meaning of Treas. Reg. § 1.415(f)-1(c), and any plan that has been merged into, consolidated with, or transferred assets to the plan in accordance with § 414(l) of the Code.

**Sample Adoption Agreement Language:**

During each Annual Election Period, a Qualified Participant may elect to direct the Plan to diversify the shares in his or her account, as determined under section \_\_\_\_\_ by one of the following methods:

**[Note to Reviewer: Add the plan section that corresponds to ESOP LRM 5.]**

|\_| Distributing such shares, or an amount equal to the value of these shares, to the Qualified Participant.

|\_| Investing an amount equal to the value of such shares in one or more of at least three alternative investment options.

|\_| Transferring an amount equal to the value of such shares to another qualified defined contribution plan of the employer that offers at least three investment options.

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**[Note to Reviewer: A plan may provide a lower amount but cannot provide a higher amount. See Notice 88-56, Q&A 7.]**

|\_| The right to elect to diversify under section \_\_\_\_\_ applies to a Qualified Participant if the fair market value of the Employer Stock allocated to his or her account is \$500 or more. For this purpose, the fair market value is determined as of the Plan's valuation date immediately preceding the first day on which a Qualified Participant is eligible to make the Diversification Election described in section \_\_\_\_\_.

**[Note to Reviewer: For both blanks above, add the plan section that corresponds to ESOP LRM 5.]**

**6. Valuation, Independent Appraiser, and Allocation of Earnings**

Statement of Requirement: Code § 401(a)(28)(C); Treas. Reg. § 54.4975-11(d)(5); Rev. Rul. 80-155, 1980-1 C.B. 84.

**[Note to Reviewer: See ESOP LRM 18 for the treatment of dividends if the Employer is a C corporation that intends to claim a deduction under Code § 404(k). See DC LRM 68 for treatment of earnings and losses with respect to assets other than Employer Stock.]**

**Sample Plan Language:**

The assets of the Plan will be valued at least once a year, on the date (or dates) specified in the Adoption Agreement ("Valuation Date"), and in accordance with a method consistently followed and uniformly applied in good faith.

In addition, all valuations of Employer Stock must be made by an independent appraiser who meets requirements similar to the requirements of the regulations prescribed under § 170(a)(1) of the Code. Valuations of Employer Stock must be made in good faith and based on all relevant factors for determining the fair market value of securities. In the case of a transaction between the Plan and a disqualified person within the meaning of Code § 4975(e)(2), Employer Stock will be valued as of the date of the transaction. For all other purposes, value must be determined as of the most recent valuation date under the Plan. Earnings on shares allocated to participants' accounts will be allocated to those accounts at least annually.

**Sample Adoption Agreement Language:**

The Plan's Valuation Date is \_\_\_\_\_ [add date(s)].

**[Note to Reviewer: The Plan may specify more than one date.]**

## **7. Voting Rights**

**Statement of Requirement: Code §§ 4975(e)(7) and 409(e).**

**Sample Plan Language:**

For purposes of this section \_\_\_\_\_, a "registration-type class of securities" means Employer Stock that is either a class of securities required to be registered under section 12 of the Securities Exchange Act of 1934, or a class of securities that would be required to be so registered except for the exemption from registration provided in subsection (g)(2)(H) of such section 12.

**[Note to reviewer: Add the plan section that corresponds to**

**this ESOP LRM 7.]**

If Employer Stock is a registration-type class of securities, each Participant or beneficiary is entitled to direct the Plan as to the manner in which shares of Employer Stock that are entitled to vote, and are allocated to his or her account, are to be voted.

If Employer Stock is not a registration-type class of securities, each Participant or beneficiary is entitled to direct the Plan as to the manner in which voting rights under the shares of Employer Stock allocated to his or her account are to be exercised with respect to any corporate matter that involves the voting of the shares of Employer Stock with respect to the approval or disapproval of any corporate merger or consolidation, recapitalization, reclassification, liquidation, dissolution, or sale of substantially all assets of a trade or business.

**[Note to Reviewer: A plan meets the requirements of this paragraph if (A) the plan permits each participant one vote with respect to such issue, and (B) the trustee votes the shares held by the plan in the proportion determined after application of (A).]**

#### **8. Right to Demand Employer Securities and Mandatory Put**

**Statement of Requirement: Code § 409(h) (1) (A) , 409(h) (2) , 409(h) (4) , and 409(h) (5) .**

**[Note to Reviewer: ESOPs maintained by C corporations must give the participant the right to demand that distributions be made in the form of employer securities. ESOPs maintained by an employer who is an S corporation, or whose charter or bylaws restrict the ownership of substantially all outstanding employer securities to employees or to a 401(a) trust, are not subject to this requirement.**

**If, however, an ESOP is maintained by an S corporation or a corporation with restricted ownership, the ESOP may distribute employer stock subject to a requirement that it must be resold to the employer ("Mandatory Put").**

**The sample plan provisions below include language for a C corporation and for an S corporation. A plan may either contain only the language appropriate for the employer's corporate or ownership status, or it may contain both the C and S provisions.**

**This section provides sample plan and adoption agreement language for the mandatory put option set forth in Code § 409(h)(2)(B) that is available to S corporations or employers with restricted ownership. See ESOP LRM 9 for the put option set forth in Code § 409(h)(1)(B).]**

**Sample Plan Language:**

If the Employer is a C corporation, distributions will be made in cash or stock, as elected by the Employer in the Adoption Agreement. However, if the Employer elects in the Adoption Agreement that distributions will be made in cash, Participants who are entitled to distributions from the Plan have the right to demand that their benefits be distributed in the form of Employer Stock.

If the Employer is an S corporation, or if the Employer is a corporation whose charter or bylaws restrict the ownership of substantially all outstanding employer securities to employees or to a trust described in Code § 401(a), the Employer may elect in the Adoption Agreement that a Participant who is entitled to a distribution will either receive the distribution in cash, or in Employer Stock subject to a requirement that the Employer Stock must be sold to the Employer ("Mandatory Put") under a fair valuation formula that meets the requirements of Plan section \_\_\_\_\_.

**[Note to Reviewer: Add the plan section that corresponds to ESOP LRM 6. The plan may specify that stock will be sold to either the Employer or the Plan's trust.]**

If the Employer is an S corporation, or if the Employer is a corporation whose charter or bylaws restrict the ownership of substantially all outstanding employer securities to employees or to a trust described in Code § 401(a), and the Employer elects the Mandatory Put option in the Adoption Agreement, and if Employer Stock is distributed as part of an installment distribution, payment will be made within 30 days of the date that the Participant sells the Employer Stock to the Employer or Plan.

If the Employer is an S corporation, or if the Employer is a corporation whose charter or bylaws restrict the ownership of substantially all outstanding employer securities to employees or to a trust described in Code § 401(a), and the Employer elects the Mandatory Put option in the Adoption Agreement, and if the Employer Stock is distributed as part of a total distribution, payment will commence within 30 days after the

date that the Participant sells the Employer Stock to the Employer or Plan. As selected by the Employer in the Adoption Agreement, payment may be made in a single payment or in substantially equal, periodic payments (not less frequently than annually) over a period not exceeding five years, with adequate security provided and interest payable at a reasonable rate. For purposes of this section, a "total distribution" is a distribution, within one taxable year of the balance to the credit of the Participant's account, and any other distribution is an "installment distribution."

**Sample Adoption Agreement Language for C Corporations**

**If the Plan is maintained by a C corporation:**

A participant who is entitled to a distribution will receive the distribution in cash.

A participant who is entitled to a distribution will receive the distribution in Employer Stock.

**Sample Adoption Agreement Language for S Corporations and restricted ownership corporations:**

If the Plan is maintained by an S corporation or by a corporation whose charter or bylaws restrict the ownership of substantially all outstanding employer securities to employees or to a 401(a) trust:

A participant who is entitled to a distribution will receive the distribution in cash.

Mandatory Put: A participant who is entitled to a distribution will receive the distribution in Employer Stock and must sell such Employer Stock to the Employer.

Payment for a Mandatory Put of a total distribution will be made in

a single payment, or

substantially equal periodic payments that occur at least annually for

one year

two years

three years

|\_\_| four years

|\_\_| five years

## 9. Put Option

**Statement of Requirement:** Code § 409(h) (1) (B) , 409(h) (2) (B) (i) , 409(h) (4) , and 409(h) (5) ; Treas. Reg. § 54.4975-11(a) (7) .

[Note to Reviewer: If the Employer is an S corporation, or has its ownership restricted as described in Code § 409(h) (2) (B) (ii) (I) , and if distributions of stock are required to be resold to the Employer ("Mandatory Put") , this ESOP LRM 9 is not applicable. Use ESOP LRM 8.

The plan may provide for put option periods that exceed 60 days. For example, the put option period could begin on the date following the date of distribution and end at least 60 days after the date the value of the Employer Stock in the distribution is furnished to the Participant.

The plan must not provide for any put option other than as described in ESOP LRM 8, ESOP LRM 9, or Code § 409(h). Also, the ESOP must not otherwise obligate itself to acquire securities from a particular security holder at an indefinite time determined upon the happening of an event such as the death of the holder.]

### Sample Plan Language:

The Employer, or the Plan, will purchase Employer Stock that has been distributed to a Participant or Beneficiary if the Participant or Beneficiary offers the Employer Stock for sale to the Employer or the Plan (put option) during one of the two put option periods described below. A fair valuation formula that meets the requirements of Plan section \_\_\_\_\_ will be used to determine the amount to be paid to the Participant or beneficiary.

**[Note to Reviewer: Add the plan section that corresponds to ESOP LRM 6.]**

The first put option period is the period of 60 days beginning on the date following the date that the Employer Stock is distributed to the Participant or beneficiary. The second put option period is a period of 60 days in the following plan year.

If the Employer Stock is distributed as part of an installment distribution, payment will be made within 30 days of the date that the Participant offers to sell the Employer Stock to the Employer or Plan. If the Employer Stock is distributed as part of a total distribution, payment will commence within 30 days after the date that the Participant offers to sell the Employer Stock to the Employer or Plan. As selected by the Employer in the Adoption Agreement, payment on a total distribution may be made in a single payment or in substantially equal, periodic payments (not less frequently than annually) over a period not exceeding five years, with adequate security provided and interest payable at a reasonable rate. For purposes of this paragraph, a "total distribution" is a distribution, within one taxable year, of the balance to the credit of the Participant's account, and any other distribution is an "installment distribution."

**Sample Adoption Agreement Language:**

Payment for Employer Stock that has been distributed as part of a total distribution and put to the Employer or Plan will be made in

a single payment, or

substantially equal periodic payments that occur at least annually for:

one year

two years

three years

four years

five years

**10. Distribution and Payment**

**Statement of Requirement: Code §§ 409(o), 401(a)(11)(B)(iii) and 401(a)(11)(C).**

**[Note to Reviewer: The sample plan and adoption agreement language in this ESOP LRM are the minimum provisions that will**

comply with Code § 409(o) and should be added at the end of the plan provision that reflects DC LRM 45 [pertaining to Code § 401(a)(14)]. In no event can distribution begin later than would be required under Code § 401(a)(14). Provisions that reflect the delayed distribution described in Code § 409(o)(1)(B) are permitted.

Variations on this sample language in which the plan specifically sets forth the method and timing in a manner that does not allow for any discretion may also comply with Code § 409(o). Factors in those variations could include, for example, the type of distributable event (normal retirement age, death, disability, or other separation from service), the size of the participant's vested account balance, commencement date of distributions, length of distribution period, form (cash or stock), and method of distribution (lump sum or installments). The plan must comply with the nondiscrimination requirements in form and in operation.

A plan may provide, for example, that the commencement of distributions, length of distribution period, or the method of distributions is based on a specified amount of the participant's vested account balance or the type of distributable event. The following are examples of approaches that could be the basis for a plan's distribution provisions:

- account balances under a specified limit will be distributed in a lump sum, while those in excess of that limit will be distributed in a set number of annual installments that complies with Code § 409(o)(1)(C);
- participants who exercise their right to demand stock will receive a lump sum distribution, while those who receive cash will receive their account balance in 5 annual installments; and
- distributions based on death could begin as soon as administratively feasible following death (but no later than one year after the close of the plan year in which the participant dies), while distributions based on normal retirement age could begin no later than one year after the close of the plan year in which the participant attained normal retirement age.

With respect to the method of distribution, an ESOP is exempt from the joint and survivor annuity requirement, but only if it satisfies the requirements of Code § 401(a)(11)(B)(iii) [plan

provides that a participant's nonforfeitable benefit is paid to the surviving spouse; plan contains no life annuity option; and the plan is not a transferee plan as described in Code § 401(a)(11)(B)(iii)(III)].

See the following definitions:

ESOP LRM 4 (Employer Stock);

ESOP LRM 12 (Exempt Loan);

DC LRM 8 (Disability); and

DC LRM 14 (Normal Retirement Age).]

**Sample Plan Language:**

If the Participant and, if applicable pursuant to Code §§ 401(a)(11) and 417, with the consent of the Participant's spouse, elects, the distribution of the Participant's account balance will begin no later than one year after the close of the Plan Year in which the Participant separates from service by reason of the attainment of Normal Retirement Age, Disability, or death.

If the Participant separates from service for a reason other than attainment of Normal Retirement Age, Disability, or death, and if the Participant elects, the distribution of the Participant's account balance will begin during the year, as selected by the Employer in the Adoption Agreement, after the close of the plan year in which the Participant separates from service.

In no event will distributions begin later than would be required under Plan section \_\_\_\_\_.

**[Note to Reviewer: Add the plan section that corresponds to DC LRM 45.]**

Unless the Participant elects otherwise, the distribution of the Participant's account balance will be in substantially equal periodic payments that occur at least annually for no more than five years, as selected by the Employer in the Adoption Agreement. If a Participant has an account balance that exceeds \$1,330,000 (for 2023) and does not elect otherwise, the distribution of the Participant's account balance will be in

substantially equal periodic payments that occur at least annually for five years plus one additional year (but not more than five additional years) for each \$265,000 (for 2023) or fraction thereof by which the Participant's account balance exceeds \$1,330,000. These dollar amounts are adjusted for changes in the cost of living by the Secretary of the Treasury at the same time and in the same manner as under Code § 415(d).

**[Note to Reviewer: The statutory dollar amounts of \$800,000 and \$160,000 can be used in place of the 2023 amounts. IRC 409(o) (1) (C).]**

**Sample Adoption Agreement Language:**

Distributions of vested account balances will begin during the year after the close of the

first plan year

second plan year

third plan year

fourth plan year

fifth plan year

following the plan year in which the Participant separates from service for a reason other than attainment of normal retirement age, death, or disability.

Distributions of vested account balances will be in substantially equal periodic installments that occur at least annually for

one year

two years

three years

four years

five years

## 11. Right of First Refusal

**Statement of Requirement: Treas. Reg. § 54.4975-7(b)(9).**

**[Note to Reviewer: Shares of qualifying employer securities acquired with the proceeds of an exempt loan may, but need not, be subject to a right of first refusal if they are not readily tradable at the time the right may be exercised.]**

### **Sample Plan Language:**

If selected in the Adoption Agreement, shares of Employer Stock acquired with the proceeds of an Exempt Loan are subject to a Right of First Refusal as described in this paragraph. The Right of First Refusal must be in favor of the Employer, the Plan, or both in any order of priority. The selling price and other terms under the right must not be less favorable to the seller than the greater of a good faith determination of the fair market value of the security as determined under section \_\_\_\_\_ or the purchase price and other terms offered by a buyer, other than the Employer or the Plan, making a good faith offer to purchase the shares of Employer Stock. The Right of First Refusal must lapse no later than 14 calendar days after the holder of Employer Stock gives written notice to the holder of the Right of First Refusal that an offer by a third party to purchase the Employer Stock has been received.

**[Note to Reviewer: Add the plan section that corresponds to ESOP LRM 6.]**

### **Sample Adoption Agreement Language:**

|\_\_| Shares of Employer Stock acquired with the proceeds of an Exempt Loan are subject to a Right of First Refusal as described in section \_\_\_\_\_ of the Plan.

**[Note to Reviewer: Add the plan section that corresponds to ESOP LRM 11.]**

## Part II - Leveraged ESOPs

### 12. Exempt Loans

**Statement of Requirement: Code § 4975(d)(3); Treas. Regs. §§ 54.4975-7 and 54.4975-11(c).**

[Note to Reviewer: Under section 9.04(8) of Rev. Proc. 2023-37, an ESOP will not receive a favorable opinion letter unless it includes provisions that set forth the requirements relating to exempt loans as described in Code § 4975(d)(3) and Treas. Regs. §§ 54.4975-7 and 54.4975-11(c). Employers who do not have, or intend to have, a leveraged ESOP may elect for provisions reflecting this ESOP LRM 12 not to apply to their plans.]

#### **Sample Plan Language:**

##### Exempt Loans

The trustee may incur an Exempt Loan only if it meets the requirements of this section.

#### 1. Definitions of Exempt Loan and Suspense Account

"Exempt Loan" means a loan that satisfies the provisions of this section \_\_\_\_\_. For purposes of the Plan, "loan" means a loan made to the Plan by a disqualified person or a loan to the Plan that is guaranteed by a disqualified person. "Loan" includes a direct loan of cash, a purchase-money transaction, and an assumption of the obligation of the Plan. "Guarantee" includes an unsecured guarantee and the use of assets of a disqualified person as collateral for a loan, even though the use of assets may not be a guarantee under applicable state law. For purposes of section \_\_\_\_\_, "disqualified person" means a disqualified person as defined in Code § 4975(e)(2).

**[Note to Reviewer: For both blanks above, add the plan section that corresponds to ESOP LRM 12.]**

"Suspense Account" means the account established under the Plan to hold shares of Employer Stock and other assets acquired with the proceeds of an Exempt Loan that have not been allocated to the accounts of participants.

## 2. Purpose, Terms, Interest Rate

An Exempt Loan must be primarily for the benefit of the participants and their beneficiaries. The terms of an Exempt Loan must be at least as favorable to the Plan as the terms of a comparable loan resulting from an arm's length negotiation between independent parties. The interest rate of an Exempt Loan must not exceed a reasonable rate of interest. An Exempt Loan must be for a specific term.

The proceeds of any Exempt Loan must be used within a reasonable time after their receipt to acquire Employer Stock, to repay such Exempt Loan, or to repay a prior Exempt Loan. All assets acquired by the Plan with the proceeds of an Exempt Loan must be added to and maintained in the Suspense Account.

## 3. Liability, Recourse, Collateral, and Payments

Any Exempt Loan must be without recourse against the Plan. The only Plan asset that may be used as collateral on an Exempt Loan is Employer Stock acquired with the Exempt Loan, or Employer Stock 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 has any right to Plan assets other than collateral given for the Exempt Loan, contributions (other than contributions of Employer Stock) that are made under the Plan to meet its obligations under the Exempt Loan, and earnings attributable to such collateral and the investment of such contributions.

Payments made by the trustee with respect to any Exempt Loan during a plan year must not exceed an amount equal to the sum of (1) contributions (other than contributions of Employer Stock) that are made under the Plan to meet its obligations under the Exempt Loan, and (2) earnings attributable to collateral given for the Exempt Loan and the investment of such contributions received during or prior to the year less such payments in prior years. Such contributions and earnings must be accounted for separately in the books of account of the ESOP until the Exempt Loan is repaid.

## 4. Not payable upon Demand and Default

The Exempt Loan cannot be payable upon the demand of any person except in the event of default. In the event of default upon an Exempt Loan, the value of the Plan assets transferred by the trustee in satisfaction of the Exempt Loan must not exceed the

amount of default. If the lender is a disqualified person, the Exempt Loan must provide for a transfer of Plan assets upon default only upon and to the extent of the failure of the Plan to meet the payment schedule of the Exempt Loan. For purposes of this paragraph, the making of a guarantee does not make a person a lender.

#### 5. Release from Suspense Account

**[Note to Reviewer: The plan may provide that the trustee may decide to apply the release rules solely with reference to principal payments, if the Exempt Loan meets the requirements described in the Principal Payment Release Method below.]**

An Exempt Loan must provide for the release of shares from the Suspense Account in accordance with either the Principal and Interest Payment Release Method or the Principal Payment Release Method as described in this section.

Principal and Interest Payment Release Method: For each Plan Year during the duration of the Exempt Loan, the number of shares of Employer Stock released from the Suspense Account must equal the number of shares of Employer Stock held in the Suspense Account immediately before the release for the current Plan Year multiplied by a fraction. The numerator must be the amount of the principal and interest paid on the Exempt Loan for that Plan Year, and the denominator must be the sum of the numerator plus the total payments of principal and interest to be paid for all future Plan Years.

The number of future years under the Exempt Loan must be definitely ascertainable and must be determined without taking into account any possible extensions or renewal periods.

If the interest rate under the Exempt Loan is variable, the interest to be paid in future years must be computed by using the interest rate applicable as of the end of the Plan Year.

If collateral includes more than one class of securities, the number of securities of each class to be released for a Plan Year must be determined by applying the same fraction to each class.

Principal Payment Release Method: Shares of Employer Stock are released from the Suspense Account solely with reference to principal payments in the fraction described above. However, this Principal Payment Release Method cannot be used unless these conditions are met: (1) The Exempt Loan must provide for

annual payments of principal and interest at a cumulative rate that is not less rapid at any time than level annual payments of such amounts for 10 years; (2) interest included in any payment is disregarded only to the extent that it would be determined to be interest under standard loan amortization tables; and (3) the Principal Payment Release Method cannot be used beginning from the time that, by reason of a renewal, extension, or refinancing, the sum of the expired duration of the Exempt Loan, the renewal period, the extension period, and the duration of a new Exempt Loan exceeds 10 years.

## 6. Protections and Rights

Except for the put options described in sections \_\_\_\_\_ and the right of first refusal described in section \_\_\_\_\_ of the Plan, no share of Employer Stock acquired with the proceeds of an Exempt Loan may be subject to a put, call or other option, or buy-sell or similar arrangement while held by and when distributed from the Plan, whether or not the Plan is then an ESOP. The protections and rights described in this paragraph and in sections \_\_\_\_\_ of the Plan are non-terminable and must continue to exist under the terms of the Plan, regardless of whether or not the Plan continues to be an ESOP or whether the Exempt Loan is repaid.

**[Note to Reviewer: For both blanks above, add the plan sections that correspond to ESOP LRMs 8 and 9, and if there is a right of first refusal, ESOP LRM 11.]**

### **Sample Adoption Agreement Language:**

**[Note to Reviewer: Employers who do not have, or intend to have, a leveraged ESOP may elect below for the plan section corresponding to ESOP LRM 12 to not apply.]**

The Exempt Loan provisions contained in section \_\_\_\_\_ do not apply. If this box is checked, and if the ESOP becomes leveraged, this plan must be amended to include section \_\_\_\_\_ prior to an Exempt Loan being incurred.

**[Note to Reviewer: For both blanks above, add the plan section that corresponds to ESOP LRM 12.]**

### 13. Special Code § 415 rules

**Statement of Requirement: Code § 415(c)(6); Treas. Reg. § 1.415(c)-1(f).**

[Note to Reviewer: DC LRM 31 provides sample Code § 415 language. To determine the amount of employer contributions for purposes of calculating annual additions under section 4.1 of DC LRM 31, add the sample plan language below. With respect to the amount of annual additions based on an Exempt Loan repayment, a plan may use either Alternative A (Employer contributions of both principal and interest), or Alternative B (fair market value of shares released from the suspense account on account of the repayment and allocated to participants if that amount is less than the employer contributions of both principal and interest.)]

#### **Sample Plan Language:**

##### Alternative A: Employer contributions

If an Exempt Loan has been made to the Plan, the amount of an Employer contribution that is considered to be an annual addition under \_\_\_\_\_ is calculated with respect to Employer contributions of both principal and interest used to repay the Exempt Loan for the limitation year.

**[Note to Reviewer: Add the plan section that corresponds to section 4.1 of DC LRM 31.]**

##### Alternative B: Fair market value of released shares

If an Exempt Loan has been made to the Plan, the amount of an Employer contribution that is considered to be an annual addition under \_\_\_\_\_ is calculated with respect to the fair market value of shares released from the suspense account on account of the Exempt Loan repayment and allocated to participants if that amount is less than the Employer contribution of both principal and interest. If that amount is more than the Employer contribution of both principal and interest, then the amount of an Employer contribution that is considered to be an annual addition under \_\_\_\_\_ is calculated with respect to Employer contributions of both principal and interest used to repay the Exempt Loan for the limitation year.

[Note to Reviewer: For both blanks above, add the plan section that corresponds to section 4.1 of DC LRM 31.

Use the following sample plan language in addition to Alternative A or Alternative B above. Note that this provision modifies the employer contribution and forfeiture portions of section 4.1 in DC LRM 31. This provision is required for ESOPs maintained by Employers who are C corporations. S corporation Employers may include it even though it would not be applicable to their ESOP.]

If the Employer is a C corporation and no more than one-third of the Employer contributions that are used to repay the principal and interest due on an Exempt Loan and that are deductible under Code § 404(a)(9) are allocated to the accounts of Highly Compensated Employees as defined in \_\_\_\_\_ during the Plan Year, then annual additions described in section \_\_\_\_\_ do not include forfeitures of the Employer Stock purchased with the proceeds of an Exempt Loan and also do not include Employer contributions that are used to pay interest on an Exempt Loan and are deductible under Code § 404(a)(9)(B) and charged against the Participant's account.

[Note to Reviewer: For the first blank, add the plan section that corresponds to DC LRM 11. For the second blank, add the plan section that corresponds to DC LRM 31, section 4.1, as modified by this ESOP LRM 13.]

### **Part III - Special Provisions**

#### **14. Forfeitures**

**Statement of Requirement: Treas. Reg. § 54.4975-11(d)(4).**

[Note to Reviewer: See DC LRMs 39, 40, and 41 for other forfeiture provisions.]

#### **Sample Plan Language:**

If a portion of a Participant's account is forfeited, Employer Stock released from the suspense account and allocated to the Participant's account must be forfeited only after other assets. If shares in more than one class of such Employer Stock have been allocated to the participant's account, the same proportion of each class will be forfeited.

## 15. Prohibited Allocations of Securities in an S Corporation

**Statement of Requirement: Code § 409(p); Treas. Reg. § 1.409(p)-1.**

**[Note to Reviewer: This provision is required for S corporations. C corporations may include it even though it would not be applicable to their ESOPs.]**

### **Sample Plan Language:**

Notwithstanding anything herein to the contrary, if Employer Stock is stock in an S corporation, no portion of the assets of the Plan attributable to (or allocable in lieu of) Employer Stock may, during a Nonallocation Year, accrue as described below ("Impermissible Accrual"), or be allocated as described below ("Impermissible Allocation") directly or indirectly under the Plan or any other qualified plan of the Employer for the benefit of any Disqualified Person.

#### Impermissible Accrual

In a Nonallocation Year, all Employer Stock consisting of shares in the S corporation and all other Plan assets attributable to S corporation shares held in a Disqualified Person's Plan account are an Impermissible Accrual for the benefit of that Disqualified Person, regardless of whether such Impermissible Accrual is attributable to contributions in the current year or prior years. Plan assets attributable to S corporation stock held in a Disqualified Person's Plan account include distributions made on such S corporation stock within the meaning of Code § 1368, proceeds from the sale of such S corporation stock, and earnings on such distributions or proceeds.

#### Impermissible Allocation

In a Nonallocation Year, an Impermissible Allocation occurs if any annual addition (as described in section \_\_\_\_ of the Plan) is made to the Plan account of a Disqualified Person. An Impermissible Allocation also occurs in a Nonallocation Year if a Disqualified Person accrues additional benefits, directly or indirectly, under the Plan or any other qualified plan of the Employer that would have been allocated to the Plan account of the Disqualified Person for the Nonallocation Year and invested in Employer Stock consisting of stock in an S corporation owned

by the Plan, but for a Plan provision that precludes such allocation and investment.

**[Note to Reviewer: Add the plan section that corresponds to DC LRM 31.]**

#### Nonallocation Year

A "Nonallocation Year" is a Plan Year during which, at any time, the Plan holds any shares of Employer Stock that are shares of an S corporation and Disqualified Persons own (1) at least 50% of the number of outstanding shares of stock in the S corporation (including Deemed-Owned Shares), or (2) at least 50% of the sum of (A) the outstanding shares of stock in the S corporation (including Deemed-Owned Shares), and (B) the Synthetic Equity Shares owned by Disqualified Persons.

Solely for purposes of determining whether a Plan Year is a Nonallocation Year, Synthetic Equity Shares are only treated as owned by Disqualified Persons if such treatment results in the treatment of a Plan Year as a Nonallocation Year.

#### Nonallocation Year Attribution Rules

The "Nonallocation Year Attribution Rules" are the rules in this paragraph. Section 318(a) of the Code is applied to determine who is treated as owning Synthetic Equity Shares and shares in the S corporation (including Deemed-Owned Shares). An individual is treated as owning Synthetic Equity Shares and shares in the S corporation if such shares are attributable to the individual under § 318(a) as modified in this paragraph. In applying § 318(a)(1), the members of an individual's family include the members of the individual's family described in the Disqualified Person Family Member Rules, and § 318(a)(4) regarding stock options is disregarded. Notwithstanding the employee trust exception in § 318(a)(2)(B)(i), an individual is treated as owning Deemed-Owned Shares of the individual.

#### Disqualified Person

A "Disqualified Person" for purposes of this section \_\_\_\_\_ is:

**[Note to Reviewer: Add the plan section that corresponds to ESOP LRM 15.]**

1. Any person whose number of Deemed-Owned Shares is at least

10% of the total number of the Deemed-Owned Shares;

2. Any person whose aggregate number of Deemed-Owned Shares and Synthetic Equity Shares is at least 10% of the sum of (a) the total number of Deemed-Owned Shares and (b) such person's Synthetic Equity Shares;

3. Any person whose number of Deemed-Owned Shares, together with the number of Deemed-Owned Shares of the Members of the Family of such person, is at least 20% of the total number of Deemed-Owned Shares; or

4. Any person whose aggregate number of Deemed-Owned Shares and Synthetic Equity Shares, together with the aggregate number of Deemed-Owned Shares and Synthetic Equity Shares of the Members of the Family of such person, is at least 20% of the sum of (a) the total number of Deemed-Owned Shares and (b) the Synthetic Equity Shares owned by such person and the Members of the Family of such person.

Solely for purposes of determining whether a person is a Disqualified Person, a person is only treated as owning Synthetic Equity Shares if such treatment results in that person being treated as a Disqualified Person.

#### Disqualified Person Family Member Rules

The Disqualified Person Family Member Rules are the following rules. "Disqualified Person" includes any person who owns any Deemed-Owned Shares or Synthetic Equity Shares and who is a Member of the Family of a Disqualified Person described in paragraph 3 or paragraph 4 of the Disqualified Person section.

"Member of the Family" means, with respect to an individual, -

1. The spouse of the individual;

2. An ancestor or lineal descendent of the individual or of the individual's spouse, and the spouse of such ancestor or lineal descendant; and

3. A brother or sister of the individual or of the individual's spouse and any lineal descendant of such brother or sister, and the spouse of such brother or sister or lineal descendant.

Member of the Family does not include a spouse who is legally separated under a decree of divorce or separate maintenance.

### Deemed-Owned Shares

"Deemed-Owned Shares" means Employer Stock that is stock in the S corporation allocated to a person's ESOP account. Deemed-Owned Shares also includes a person's share of the stock in such S corporation that is held by the ESOP but that has not been allocated to the accounts of participants or beneficiaries. A person's share of such unallocated S corporation stock is determined in the same proportion as the shares released and allocated from the Suspense Account under sections \_\_\_\_\_ of the Plan for the most recently ended plan year for which there were shares released and allocated from the Suspense Account. If there has been no such prior release and allocation from the Suspense Account, a person's share of such unallocated S corporation stock is determined in proportion to a reasonable estimate of the shares that would be released and allocated in the first year of an Exempt Loan repayment.

**[Note to Reviewer: Add the plan sections that correspond to paragraph 5 of ESOP LRM 12 and to DC LRM 25.]**

### Synthetic Equity

"Synthetic Equity" is any right described in the following categories and is treated as owned by the person who has any of these rights. The Nonallocation Year Attribution Rules apply for purposes of determining ownership.

Category 1. S corporation stock and payments based on the value of S corporation stock: Synthetic Equity in this category is a right to acquire or receive stock of the S corporation, including a stock option, warrant, restricted stock, deferred issuance stock right, stock appreciation right payable in stock, or similar interests or rights. Synthetic Equity in this category is also a right to a future payment (payable in cash or any other form other than stock of the S corporation) from an S corporation that is based on the value of the stock of the S corporation, such as stock appreciation. Synthetic equity does not include certain rights of first refusal as described in § 1.409(p)-1(f)(2)(i)(B) of the Treasury Regulations.

Category 2. Related Entity: Synthetic Equity in this category is a right to acquire stock or other similar interests in a Related Entity, but only to the extent of the S corporation's ownership. A Related Entity is any entity in which the S corporation holds an interest and that is a partnership, a trust, an eligible entity that is disregarded as an entity that

is separate from its owner under § 301.7701-3 of the Treasury Regulations, or a qualified subchapter S subsidiary under § 1361(b)(3) of the Code.

Category 3. Certain assets, certain fringe benefits and Nonqualified Deferred Compensation: Synthetic Equity in this category is a right to acquire assets of an S corporation or a Related Entity (but only to the extent of the S corporation's ownership of such entity) other than either rights to acquire goods, services, or property at fair market value in the ordinary course of business, or fringe benefits excluded from gross income under Code § 132. Synthetic Equity also includes "Nonqualified Deferred Compensation", which is nonqualified deferred compensation as described in § 1.409(p)-1(f)(2)(iv) of the Treasury Regulations with respect to an S corporation or Related Entity, and which includes any remuneration for services under a plan, method, or arrangement deferring the receipt of compensation to a date that is after the 15<sup>th</sup> day of the 3<sup>rd</sup> calendar month after the end of the entity's taxable year in which the related services are rendered. However, Synthetic Equity does not include benefits under a plan that is an eligible retirement plan within the meaning of § 402(c)(8)(B) of the Code.

#### Synthetic Equity Shares

"Synthetic Equity Shares" are shares of Synthetic Equity, the number of which is determined as described below, without regard to lapse restrictions as described in § 1.83-3(i) of the Treasury Regulations.

S corporation stock and payments based on the value of S corporation stock: The person who is entitled to Synthetic Equity that is determined by reference to S corporation stock (see the rights listed in Synthetic Equity Category 1) is treated as owning the number of shares of stock deliverable pursuant to such Synthetic Equity. If such Synthetic Equity is a right to purchase or receive S corporation shares, the corresponding number of Synthetic Equity Shares is determined without regard to any amount required to be paid in exchange for the S corporation shares. If such Synthetic Equity is a right to payment in cash or other non-S corporation stock property, the number of Synthetic Equity Shares treated as owned is equal to the number of shares of stock having a fair market value equal to the cash or other non-S corporation stock property.

Shares in a Related Entity: The person who is entitled to

Synthetic Equity that is determined by reference to shares of stock (or similar interests) in a Related Entity (see the rights listed in Synthetic Equity Category 2) is treated as owning shares of stock of the S corporation with the same aggregate value as the number of shares of stock (or similar interests) of the Related Entity.

Certain assets and Nonqualified Deferred Compensation: The person who is entitled to Synthetic Equity determined by reference to the assets and Nonqualified Deferred Compensation described in Synthetic Equity Category 3 is treated as owning on any date the number of shares of stock in the S corporation equal to the present value of such Synthetic Equity divided by the fair market value of a share of the S corporation's stock, determined as of the date elected in the Adoption Agreement ("Determination Date"). However, if the Employer elects in the Adoption Agreement, the number of shares of Synthetic Equity in Category 3 will be fixed for the 3-year period beginning with the Determination Date on which that number of shares was determined and ending on the day before the third anniversary of the Determination Date ("Triennial Calculation").

Adjustment of number of Synthetic Equity Shares if ESOP owns less than 100 percent of the S corporation: The number of Synthetic Equity Shares otherwise determined under this Plan section \_\_\_\_\_ is decreased ratably to the extent that shares of the S corporation are owned by a person who is not an ESOP and who is subject to Federal income taxes.

**[Note to Reviewer: Add the plan section that corresponds to ESOP LRM 15.]**

**Sample Adoption Agreement Language:**

Determination Date

The Determination Date(s) is(are) \_\_\_\_\_ [must be at least annually].

Triennial Calculation

|\_\_| The number of shares of Synthetic Equity in Category 3 will be fixed for the 3-year period beginning with the Determination Date on which that number of shares was determined and ending on the day before the third anniversary of that Determination Date ("Triennial Calculation"), using the aggregate present value of the Category 3 Synthetic Equity (including all grants made

during the 3-year period).

**[Note to reviewer: If the Employer does not elect the Triennial Calculation, then, under the provisions of this ESOP LRM section 15, the shares of Category 3 Synthetic Equity will be calculated annually on the Determination Date.]**

#### **16. Use of Transfers to Prevent a Code § 409(p) Nonallocation Year**

**Statement of Requirement: Treas. Reg. § 1.409(p)-1(b)(v).**

**[Note to Reviewer: This provision is recommended but not required for an ESOP maintained by an Employer who is an S corporation. C corporation Employers may include it even though it is not applicable to their ESOPs. An ESOP may provide that the payment of taxes on unrelated business taxable income under Code § 512(e) may be paid from the accounts of participants who have an account in the Non-ESOP Portion of the plan containing Transferred Shares.]**

#### **Sample Plan Language:**

Non-ESOP Portion. Assets held under the Plan in accordance with this section are held under a portion of the Plan that is not an ESOP within the meaning of § 4975(e)(7) of the Code ("Non-ESOP Portion"). Amounts held in the Non-ESOP Portion will be held in accounts that are separate from the accounts in the remainder of the Plan (ESOP, or the "ESOP Portion"). Any statements provided to Participants to show their interests in the Plan will separately identify the amounts held in each such portion. Except as specifically set forth in this section, all of the terms of the Plan apply to any amount held under the Non-ESOP Portion in the same manner and to the same extent as an amount held under the ESOP Portion.

#### Transfers from ESOP Portion to Non-ESOP Portion to Avoid a Nonallocation Year.

If the plan administrator determines that a future event, such as a contribution to the Plan of shares of Employer Stock, would cause a Nonallocation Year (as defined in section \_\_\_\_ ) to occur ("Nonallocation Event"), the plan administrator will reduce the account balances of Disqualified Persons by transferring as described below the number of shares of Employer Stock necessary to prevent a Nonallocation Year, as selected in the Adoption Agreement. This number of shares will be transferred ("Transferred Shares") from the ESOP Portion to the Non-ESOP Portion prior to the Nonallocation Event. Immediately

following the transfer, the number of shares transferred from a Participant's account in the ESOP Portion will be credited to an account established for that Participant in the Non-ESOP Portion. The plan administrator will take steps to ensure that all actions necessary to implement the transfer are taken before the Nonallocation Event occurs.

**[Note to Reviewer: Add the plan section that corresponds to ESOP LRM 15.]**

Shares will be transferred from the ESOP accounts of participants under whichever of the following methods results in the fewest shares being transferred:

Method 1: First reducing the ESOP account of the Disqualified Person whose account has the largest number of shares (with the addition of Synthetic Equity Shares), and thereafter by reducing the ESOP account of each succeeding Disqualified Person whose account has the next largest number of shares (with the addition of Synthetic Equity Shares). The ESOP account of the Disqualified Person will be reduced until that Disqualified Person is no longer a Disqualified Person, or until that account has no more shares, whichever occurs first.

Method 2: First reducing the ESOP account of the Disqualified Person who is a Highly Compensated Employee with the fewest shares (with the addition of Synthetic Equity Shares) to the extent necessary to cause the Participant not to be a Disqualified Person, and thereafter reducing the ESOP account of each succeeding Disqualified Person who is a Highly Compensated Employee whose account has the next fewest shares (with the addition of Synthetic Equity Shares) to the extent necessary to cause each such Participant not to be a Disqualified Person. The ESOP account of the Disqualified Person will be reduced until that Disqualified Person is no longer a Disqualified Person, or until that account has no more shares, whichever occurs first.

If two or more Participants have the same number of shares, the account of the Participant with the most of Years of Service (as defined in section \_\_\_\_\_) will be reduced first.

**[Note to Reviewer: Add the plan section that corresponds to DC LRM 1.]**

**Sample Adoption Agreement Language:**

Transfers to Prevent a Code § 409(p) Nonallocation Year

If necessary to prevent a Nonallocation Year as described in section \_\_\_\_\_, the Plan Administrator will transfer the minimum number of shares of Employer Stock from the ESOP accounts of Disqualified Persons to the Non-ESOP accounts of those persons that will result in Disqualified Persons owning

\_\_\_\_\_ percent [must be at least 40 but less than 50]

of the sum of the outstanding shares of stock in the S corporation (including Deemed-Owned Shares) and the Synthetic Equity Shares owned by Disqualified Persons.

**[Note to Reviewer: In the first blank, add the plan section that corresponds to ESOP LRM 15.]**

**17. Securities Acquired in a Sale under Code § 1042  
(Nonrecognition of Gain)**

**Statement of Requirement: Code §§ 409(n) and 1042.**

**[Note to Reviewer: This provision is required for ESOPs maintained by Employers who are C corporations. S corporation Employers may include it in their ESOPs even though this provision is not applicable.]**

**Sample Plan Language:**

If the Employer is a C corporation, no portion of the Plan assets attributable to (or allocable in lieu of) Employer Stock acquired by the Plan in a Code § 1042 Sale may accrue (or be allocated directly or indirectly under any plan qualified under Code § 401(a) maintained by the Employer) (1) during the Nonallocation Period for the benefit of any Nonallocation Participant, or (2) for the benefit of a 25-percent Shareholder.

Definitions:

“Employer Stock” for purposes of this section \_\_\_\_\_ means employer securities (as defined in Code § 409(1)) which are issued by a domestic C corporation that has no stock

outstanding that is readily tradable on an established securities market, and were not received by the individual who sold the securities to the Plan in a distribution from a plan described in Code § 401(a), or a transfer pursuant to an option or other right to acquire stock to which Code §§ 83, 422, or 423 applied (or to which Code §§ 422 or 424 (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990) applied).

**[Note to Reviewer: Add the plan section that corresponds to ESOP LRM 17.]**

“Section 1042 Sale” means a sale of Employer Stock to the Plan in a transaction to which Code § 1042 (providing for the nonrecognition of gain realized on sales of stock to an ESOP) applies.

“Nonallocation Period” means the period beginning on the date of the § 1042 Sale and ending on the later of the date that is 10 years after the date of the § 1042 Sale, or the date of the plan allocation attributable to the final payment of acquisition indebtedness incurred in connection with the § 1042 Sale.

“Nonallocation Participant” means any Participant who makes an election under Code § 1042(a) with respect to Employer Stock and any Participant who is related to such Participant within the meaning of Code § 267(b). “Nonallocation Participant” does not include any participant who is a lineal descendant of a Participant who makes an election under Code § 1042 if the aggregate amount allocated for the benefit of all such lineal descendants during the Nonallocation Period does not exceed more than 5 percent of the Employer Stock (or amounts allocated in lieu thereof) held by the ESOP that is attributable to a § 1042 Sale by any person related to such descendants (within the meaning of Code § 267(c)(4)).

“25-percent Shareholder” means a Participant who owns more than 25 percent of any class of outstanding stock of the Employer or any corporation that is a member of the same controlled group of corporations (within the meaning of Code § 409(1)(4)) as the Employer. “25-percent Shareholder” also means a Participant who owns more than 25 percent of the total value of any class of outstanding stock of the Employer or any corporation that is a member of the same controlled group of corporations (within the meaning of Code § 409(1)(4)) as the Employer. The rules of Code § 318(a), without regard to the employee trust exception in § 318(a)(2)(B)(i), are used to calculate the ownership

percentage. This definition is applicable at any time during either the 1-year period ending on the date of sale of such stock to the Plan, or on the date as of which Employer Stock is allocated to Participants.

## **18. Treatment of Dividends**

**Statement of Requirement: Code § 404(k) (1), (2) and (3); Treas. Regs. §§ 1.402(c)-2, Q & A-4 and 54.4975-11(d) (3) and (f) (3); Notice 2002-2, 2002-1 C.B. 285.**

[Note to Reviewer: A plan maintained by a C corporation that intends to claim a deduction under Code § 404(k) must include language that provides for dividends to be treated in one of the ways set forth in Code § 404(k) (2) and must otherwise comply with Code § 404(k). The Code § 404(k) deduction is not available to an S corporation. An S corporation Employer may, however, include this provision even though it is not applicable.

Confirm that the list of exclusions from the definition of eligible rollover distributions, found in section 2.1 of DC LRM 51, includes "dividends paid on employer securities described in § 404(k) of the Internal Revenue Code."]

### **Sample Plan Language:**

#### **Income on Plan Assets**

Section A applies to Employers that are S corporations. Employers that are C corporations must elect in the Adoption Agreement to apply either Section A or Section B.

#### **Section A: Treatment of Income on Employer Stock**

Income with respect to Employer Stock that is acquired with the proceeds of an Exempt Loan and held in the Suspense Account is allocated as income of the Plan except to the extent, if elected by the Employer in the Adoption Agreement, that such income is used to repay that Exempt Loan. If income is allocated to a Participant's or beneficiary's account, it may be distributed to that Participant or beneficiary, if the Employer so elects in the Adoption Agreement.

#### **Section B: Treatment of Dividends to be Deductible under Code § 404(k) by C Corporations**

This section applies if the Employer is a C corporation and

elects to apply this section in the Adoption Agreement.

Dividends paid in cash by the Employer with respect to Applicable Employer Stock, whether or not allocated to a Participant's account, will be used at the trustee's discretion to make payments on an Exempt Loan, the proceeds of which were used to acquire the Employer Stock with respect to which the dividend is paid. If a dividend paid with respect to Employer Stock that is allocated to a Participant's account is used to make payments on an Exempt Loan, then Employer Stock with a fair market value of not less than the amount of the dividend used to make payments on an Exempt Loan must be allocated to a Participant's account for the year that such dividend would have been allocated to the Participant's account if it were not used to make payments on an Exempt Loan.

To the extent that dividends on Applicable Employer Stock allocated to Participant accounts are not used to repay an Exempt Loan, dividends will be treated under either Option 1, Option 2, or Option 3, as elected by the Employer in the Adoption Agreement.

Option 1: Direct Cash Payment to Participant

If elected by the Employer in the Adoption Agreement, dividends with respect to Applicable Employer Stock allocated to a Participant's account will be paid in cash by the Employer to that Participant.

Option 2: Cash Payment to the Plan Followed by Distribution to Participant

If elected by the Employer in the Adoption Agreement, dividends with respect to Applicable Employer Stock allocated to a Participant's account will be paid by the Employer to the Plan and distributed in cash to that Participant not later than 90 days after the close of the plan year in which paid.

Option 3: Participant Election between Cash and Reinvestment

**[Note to Reviewer: Under Option 3, with respect to dividends on Applicable Employer Stock that is allocated to participant accounts, participants elect between cash and reinvestment in Employer Stock. The Employer chooses in the Adoption Agreement whether the cash component of the election offered to participants will be dividends paid in cash directly to the participant or dividends paid to the**

**plan and then distributed in cash to the participant.]**

If this option is elected by the Employer in the Adoption Agreement, dividends with respect to Applicable Employer Stock that is allocated to a Participant's account will be, at the election of that Participant, either (1) paid in cash to that Participant, or (2) paid to the Plan and reinvested in Employer Stock to be allocated to the account of that Participant.

If the Participant elects a cash payment, the payments shall be made, as elected by the Employer in the Adoption Agreement, either (a) directly from the Employer to the Participant, or (b) paid to the Plan and distributed in cash to that Participant not later than 90 days after the close of the plan year in which the dividends are paid to the Plan.

If a Participant fails to make an affirmative dividend election, the default election elected by the Employer in the Adoption Agreement will apply.

A Participant's election will not be valid unless the Participant is given a reasonable opportunity to:

- make the election before a dividend is paid or distributed;
- change a dividend election at least annually; and
- if there is a change in the Plan terms governing the manner in which the dividends are paid or distributed to Participants, make an election under the new Plan terms prior to the date on which the first dividend subject to the new Plan terms is paid or distributed.

#### Applicable Employer Stock

For purposes of this section, "Applicable Employer Stock" means Employer Stock as defined in section \_\_\_\_\_ that is held by the ESOP on the record date for the dividend.

**[Note to Reviewer: Add the plan section that corresponds to ESOP LRM 4.]**

**Sample Adoption Agreement Language:**

Employers that are C corporations must elect either one of the options under Section A, or Section B. C corporation Employers that elect Section B must also elect among the options in Section B. Employers that are S corporations must elect one of the options in Section A.

Section A: Treatment of Income on Employer Stock

|\_\_| Income with respect to Employer Stock that is acquired with the proceeds of an Exempt Loan and held in the Plan's suspense account is used, at the Trustee's discretion, to repay that Exempt Loan. Any income remaining after that repayment will be allocated to the accounts of Participants and beneficiaries. See \_\_\_\_.

**[Note to Reviewer: Add the plan section that corresponds to the DC LRM 68. Allocations must be made at least annually.]**

|\_\_| Income on Employer Stock that is held in the Plan's suspense account is allocated to the accounts of Participants and beneficiaries. See \_\_\_\_.

**[Note to Reviewer: Add the plan section that corresponds to the DC LRM 68. Allocations must be made at least annually.]**

|\_\_| Income that is allocated to a Participant's or beneficiary's account will be distributed to that Participant or beneficiary.

Section B: Treatment of Dividends for Deductibility under Code § 404(k) by C Corporations

|\_\_| The Employer elects to apply section \_\_\_\_ of the Plan regarding the treatment of dividends for a Code § 404(k) deduction. Employers who elect this option must elect one of the dividend treatment options below if they intend to claim a Code § 404(k) deduction.

**[Note to Reviewer: Add the plan section that corresponds to ESOP LRM 18, section B.]**

To the extent that dividends on allocated shares are not used to repay an Exempt Loan, such dividends will be treated under:

|\_\_| Option 1: Direct Cash Payment to Participant (section \_\_\_\_ of the Plan)

**[Note to Reviewer: Add the plan section that corresponds to ESOP LRM 18.]**

|\_\_| Option 2: Cash Payment to the Plan Followed by Distribution to Participant (section \_\_ of the Plan)

**[Note to Reviewer: Add the plan section that corresponds to ESOP LRM 18.]**

|\_\_| Option 3: Participant Election between Cash and Reinvestment (section \_\_\_\_\_ of the Plan)

**[Note to Reviewer: Add the plan section that corresponds to ESOP LRM 18.]**

If a participant elects to receive dividends in cash (instead of reinvestment), those dividends will be -

- (a) |\_\_| paid in cash to the Participant or
- (b) |\_\_| paid to the Plan and distributed in cash to the Participant.

Default: If a Participant fails to make an election, dividends with respect to Applicable Employer Stock allocated to a Participant's account will be -

|\_\_| (1) paid in accordance with whichever cash option, (a) or (b), was selected above, or

|\_\_| (2) reinvested in Employer Stock.

## **19. S Corporation Repayment of Exempt Loans**

**Statement of Requirement: Code § 4975(f)(7).**

**[Note to Reviewer: This provision is optional for ESOPs maintained by Employers who are S corporations. C corporation Employers may include it in their ESOPs, even though it is not applicable to them.]**

### **Sample Plan Language:**

If the Employer is an S corporation, earnings as described in Code § 1368(a) with respect to Employer Stock (whether or not the Employer Stock is allocated to the accounts of Participants) will be used at the trustee's discretion to make payments on the Exempt Loan used to acquire such Employer Stock.

If such earnings are used to make payments on such Exempt Loan, then Employer Stock with a fair market value of not less than the amount of the earnings used to make payments on the Exempt Loan must be allocated to a Participant's account for the year that such earnings would have been allocated to the Participant's account if they were not used to make payments on the Exempt Loan.

## 20. Rebalancing and Reshuffling

**Statement of Requirement:** Treas. Regs. §§ 1.401-1(a)(2), 1.401-1(b)(1)(ii) and (iii), 1.401(a)(4)-4, 1.411(d)-4, A-1(d);  
**Response to Technical Assistance Request #4, February 23, 2010.**

[Note to Reviewer: A plan may, but is not required to, provide for rebalancing or reshuffling, subject to the requirements discussed below.

"Rebalancing" is the mandatory transfer of employer securities into and out of participant plan accounts, usually on an annual basis, designed to result in all participant accounts having the same proportion of employer securities. Rebalancing, which treats all participant accounts the same, will not raise issues of current or effective availability and is generally acceptable.

"Reshuffling" is the mandatory transfer of employer securities into or out of plan accounts for administrative purposes, such as distributions, diversifications, or segregation upon termination. Reshuffling provisions present special concerns about meeting the current and effective availability requirements.

Both rebalancing and reshuffling plan provisions must meet the requirements set forth in the regulations for a definite written program and a definite predetermined allocation formula. These provisions must have language relating to the calculation of the number of shares or amount of cash to transfer in or out of plan accounts. In addition, the plan must state the manner in which the transfers will be effectuated, including the date of valuation.

Because terminated employees comprise a coverage group under Treas. Reg. § 1.401(a)(4)-10, a plan provision for reshuffling that provides for the transfer of all employer securities from plan accounts of terminated employees (also referred to as segregation) also does not raise issues of current or effective availability in form. However, a segregation provision must

include a method for determining which of the non-terminating participants' accounts, if any, will receive employer securities. For example, the plan could specify that transfers will occur pro rata, based on the amount of employer securities in the account of each non-terminating participant.

The diversification rights in Code § 401(a)(28)(B) include a participant's right not to have shares diversified pursuant to such sections mandatorily transferred back into his or her account. As a result, any rebalancing or reshuffling provision must preclude shares diversified under Code §§ 401(a)(28)(B) or 401(a)(35) from being mandatorily returned to participants' accounts.]