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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

UIC #s: 401.04-00 4972.02-00
404.00-00
404.02-00
415.00-00
415.02-00

MAY 2 8 2003

T:EP:RA:T3

LEGEND:

Company A:

Taxpayer B:

Country C:

Company D:

Business E:

Plan X:

Plan Y:

Committee W:

Escrow Account Z:

Number T:

Amount U:

Amount V:

Court P:

Court Q:

Case R:

Date 1:

Date 2:

Date 3:

Date 4:

Date 5:

Date 6:

Date 7:

Date 8:

Month 1:

Year 1:

Year 2:

Year 3:

Year 4:

Ladies and Gentlemen:

This is in response to the , letter submitted on your behalf by your authorized representative, as supplemented by correspondence dated , , in which you ask the Internal Revenue Service to issue a series of letter rulings under sections 401(a)(4), 404, 415, and 4972 of the Internal Revenue Code. The following facts and representations support your ruling request.

Company A was incorporated under the laws of Country C to engage in Business E. On Date 1, Year 1, Company A acquired by merger the business and assets of Company D. Subsequent to the merger, Company A continued to borrow heavily to invest in new capacity. However, due to its debt burden, Company A was required to file a voluntary bankruptcy petition on Date 2, Year 4, in Court P.

At the time of its acquisition by Company A, Company D maintained Plan Y, a defined contribution plan qualified within the meaning of Code § 401(a). On Date 3, Year 2, Company A established Plan X as a continuation of Plan Y, effective Date 4, Year 3. Other plans, maintained by either Company A or Company D, were either

merged into Plan X or were frozen and had their participants commence participation in Plan X.

Plan X is a defined contribution plan which contains a cash or deferred arrangement described in Code § 401(k). Your authorized representative has asserted that Plan X is qualified within the meaning of Code § 401(a). Assets in Plan X, which consist of § 401(k) contributions, after-tax contributions, and employer matching contributions are held in separate accounts under Plan X. Contributions to Plan X, including amounts transferred into Plan X from other qualified plans, may be invested in Company A stock.

On Date 6, Year 3, the right of participants to change their investment election with respect to assets and their employee contributions account was suspended to facilitate a change in recordkeeper for a blackout period that ended on Date 5, Year 4.

Plan X is administered by Committee W which is the named fiduciary of the plan. The members of Committee W are appointed and remain subject to removal by Company A's Board of Directors.

As a result of Company A's bankruptcy filing, the Company A stock held in Plan X became worthless.

Taxpayer B proposes to make a payment to Plan X to make up certain losses suffered by Plan X and its participants as a result of the circumstances described above. Taxpayer B has publicly stated that he wishes to make this payment out of concern for the Plan participants involved and because he would like an opportunity to redeem, at least in part, his business reputation.

Although the Service does not take any position with respect to Taxpayer B's stated motivation in making his payment to Plan X, in arriving at its decision to issue the requested letter rulings the Service does take notice that, subsequent to Date 7, Year 3, numerous lawsuits have been filed against present and former directors, officers, and employees of Company A and its affiliates including Taxpayer B. Many of these lawsuits have been consolidated before Court Q. A number of the pending lawsuits allege violations of Federal Securities Laws. However, several, including Case R, which was filed on behalf of participants in Plan X, allege violations of provisions of the Employee Retirement Income Security Act of 1974, as amended (ERISA). Taxpayer B is a named defendant in Case R.

Certain Paragraphs of the Case R complaint allege breaches of fiduciary duty. Allegations are made that Taxpayer B and Company A violated ERISA sections 404(a)(1)(A) and 404(a)(1)(B) (29 U.S.C. §§ 1104(a)(1)(A) and (a)(1)(B)). In effect,

Taxpayer B and Company A are alleged to have violated their obligations of loyalty to and acting in the best interests of affected plan participants.

The Case R complaint further alleges that, although the plan participants primarily had stock in their accounts, the named defendants, including Taxpayer B, withheld information from them germane to their plan holdings and germane to the stock's value. There are also allegations stated in the complaint that Company A "provided misleading information on its corporate books" by engaging in "swap" transactions in which Company A "recognized most of the revenue up front but recorded the cost as a capital expense instead of an operating expense. This practice had the effect of artificially inflating reported revenues".

Additionally, the ruling request indicates that, in Month 1, Year 4, the Department of Labor commenced an investigation of certain of the retirement plans maintained by Company A including Plan X.

Finally, there are allegations that Taxpayer B and others sold their Company A stock prior to Company A's bankruptcy. Taxpayer B is alleged to have sold Number T shares of stock for Amount V.

Case R has not yet been tried before a court and there has been no disposition on the merits or otherwise with respect to the allegations stated in the Case R complaint. In response to the Case R complaint, Taxpayer B has denied and continues to deny all of the allegations set forth therein as well as any and all liability relating to such allegations.

Taxpayer B, will pay Amount U to Plan X on behalf of plan participants affected by Company A's bankruptcy. On Date 8, Year 4, Amount U was transferred by Taxpayer B to Escrow Account Z to be held for the benefit of affected Plan X participants.

After payment of legal and other expenses, amounts currently held in Escrow Account Z will be transferred to Plan X pursuant to a proposed amendment to Plan X. The proposed amendment to Plan X will provide:

1. The definition of the group of plan participants, determined on an objective basis, whose losses the payment from Taxpayer B to Plan X, through Escrow Account Z, is intended to make up, in whole or in part;
2. That the pledged amounts will be allocated to the accounts of affected plan participants (on a pro rata basis, if necessary), to reimburse participants for the losses they suffered as a result of the worthlessness of Company A stock; and
3. that allocations will be made based on the best available data.

The proposed amendment will also provide the rules governing whether and to what extent allocations will be made to terminated plan participants, to participants who had received distributions, to former participants of Plan Y maintained by Company D who had their accounts transferred to Plan X, etc.

Finally, the proposed amendment will provide that allocation will be made with respect to Company A stock purchased with contributions to Plan X and held in the accounts of affected plan participants up to Date 2, Year 4, the date that Company A filed for bankruptcy protection (or, if applicable, Date 5, Year 4).

Taxpayer B will not share in the allocation of amounts currently held in Escrow Account Z.

Upon receipt of a favorable ruling by the Service, the escrow agent will transfer the balance in Escrow Account Z remaining after expenses to the Plan X trustee. Additionally, if the amount remaining in Escrow Account Z after payment of expenses exceeds the amount necessary to make the allocations described in the proposed amendment to Plan X, the excess, if any, will be paid directly to current and former employees of Company A.

Based on the above facts and representations, you, through your authorized representative, request the following letter rulings:

That the proposed payment, described above, from Escrow Account Z to the accounts of affected Plan X participants, which consists of amounts contributed by Taxpayer B to Escrow Account Z,

1. will not constitute a "contribution" or other payment subject to the provisions of either Code section 404 or Code section 4972;

2. will not adversely affect the qualified status of Plan X pursuant to either Code § 401(a)(4) or Code § 415; and

3. will not, when made to Plan X, result in taxable income to affected Plan X participants or their beneficiaries.

With respect to your ruling requests, Code section 404(a) provides if contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan or if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such contributions or compensation shall not be deductible under this chapter; but, if they would otherwise be deductible, they

shall be deductible under this section, however, subject to the limitations contained therein.

Code § 401(a)(4) generally provides that the contributions or benefits provided under a defined contribution plan may not discriminate in favor of highly compensated employees. Whether contributions under a defined contribution plan are discriminatory is generally determined by comparing the amount of contributions allocated to the accounts of highly compensated employees with the amount of contributions allocated to the accounts of non-highly compensated employees.

Code section 415(a) provides, in part, that a trust which is part of a pension, profit-sharing, or stock bonus plan shall not constitute a qualified trust under section 401(a) if: A) in the case of a defined benefit plan, the plan provides for the payment of benefits with respect to a participant which exceeds the limitations of subsection (b); or, B) in the case of defined contribution plan, contributions and other additions under the plan with respect to any participant for any taxable year exceed the limitations of subsection (c).

Section 1.415-6(b)(2) of the Income Tax Regulations provides that the term "annual additions" includes employer contributions which are made under the plan. Section 1.415-6(b)(2) further provides that the Commissioner may, in an appropriate case, considering all of the facts and circumstances, treat transactions between the plan and the employer or certain allocations to participants' accounts as giving rise to annual additions.

Code section 4972 imposes on an employer an excise tax on nondeductible contributions to a qualified plan. Section 4972(c) defines "nondeductible contributions" as the excess (if any) of the amount contributed for the taxable year by the employer to or under such plan over the amount allowable as a deduction under section 404 for such contributions (determined without regard to subsection (e) thereof), and the amount determined under subsection (c) for the preceding year reduced by the sum of the portion of the amount so determined returned to the employer during the taxable year and the portion of the amount so determined deductible under section 404 for the taxable year (determined without regard to subsection (e) thereof).

Code § 402(a) generally provides that amounts held in a trust that is exempt from tax under Code § 501(a) and that is part of a plan that meets the qualification requirements of Code § 401(a) will not be taxable until such time as such amounts are actually distributed to distributees under such plan.

Revenue Ruling 2002-45, 2002-29 I.R.B. 116, established guidance with respect to restorative payments to qualified pension, profit-sharing, and stock bonus plans. It

provides that a payment made to a qualified defined contribution plan is not treated as a contribution to the plan, and accordingly is not subject to the Code provisions described above, if conditions described therein are met. The determination of whether a payment to a qualified defined contribution plan is treated as a restorative payment, rather than as a contribution, is based on all of the relevant facts and circumstances.

In the specific case described in the Revenue Ruling, payments to the defined contribution plan were made in order to restore some or all of the plan's losses due to an action (or a failure to act) that created a reasonable risk of liability for breach of fiduciary duty. The Revenue Ruling also pointed out that payments made to a plan to make up for losses due to market fluctuations are generally treated as contributions and not as restorative payments. In no case will amounts paid in excess of the amount lost (including appropriate adjustments to reflect lost earnings) be considered restorative payments. Furthermore, payments that result in different treatment for similarly situated plan participants are not restorative payments. The failure to allocate a share of the payment to the account of a fiduciary responsible for the losses does not result in different treatment for similarly situated participants. In no event are payments required under a plan or necessary to comply with a requirement of the Code considered restorative payments, even if the payments are delayed or otherwise made in circumstances under which there has been a breach of fiduciary duty.

In this case, notice has been taken of a number of suits filed against Company A and various named individuals including Taxpayer B. Several of said suits, including Case R, (above), allege that the named defendants, including Taxpayer B, breached their fiduciary duty to the Plan and affected Plan participants by violating several sections of Title I of ERISA.

In this case, the payment which Taxpayer B has placed in Escrow Account Z and which he intends to have transferred to Plan X, which payment is referred to above, will ensure that the affected participants in Plan X recover a portion of their account balances and place them in the position similar to that in which they would have been in the absence of the circumstances described herein. Thus, it is reasonable to characterize this payment as a replacement payment rather than a plan contribution or annual addition.

As indicated by the facts of this case, the replacement payment will be made by Taxpayer B, and will be allocated to the accounts of participants and beneficiaries under Plan X that incurred losses under the circumstances described herein. The payment will be allocated to the accounts of these affected participants, if necessary, on a pro rata basis. Accordingly, plan participants who are similarly situated will be treated similarly with regard to the allocation of the payment. The fact that Taxpayer B will not receive any portion of the payment does not change this conclusion. Accordingly, we conclude

that, based on the facts and representations above, in accordance with Rev. Rul. 2002-45, the payment of the Amount U, less expenses, to Plan X is a restorative payment.

Thus, based on the above, we conclude the proposed restorative payment: 1) will not be treated as a contribution to Plan X under Code section 404 and will not be subject to the excise tax on excess contributions under Code section 4972; 2) will be treated as a restorative payment to Plan X and, therefore allocated as such, rather than being treated as a contribution for purposes of Code section 401(a)(4); 3) as a restorative payment, will not be subject to limitations on allocations under Code section 415(c); and (4), when paid to Plan X and allocated to the accounts of affected plan participants, will not be treated as having been distributed to said plan participants for purposes of Code § 402.

This ruling is based on the assumption that Plan X meets the requirements of Code section 401(a), and that its related trust is tax-exempt within the meaning of Code section 501(a). No opinion is expressed as to the Federal income tax consequences or the transactions described above under any other provisions of the Code.

Additionally, the representations made herein that the facts described herein including the facts surrounding the payment described in this letter ruling, like all factual representations made to the Internal Revenue Service in applications for rulings, are subject to verification on audit by Service field personnel.

A copy of this letter has been sent to your authorized representative in accordance with the power of attorney on file in this office.

If you have any questions, please call , T:EP:RA:T3 at .

Sincerely yours,

Frances V. Sloan

Frances V. Sloan
Manager, Technical Group 3
Tax Exempt and Government
Entities Division

Enclosures:
Deleted copy of letter
Notice of Intention to Disclose