



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

MAY 16 2007

Release Number: 200732028
Release Date: 8/10/2007

T:EP:RA:T3

LEGEND:

Company A:

Plan X:

Dear

This is in response to your request for a private letter ruling dated August 18, 2003, as supplemented by letters dated January 20, 2004, February 9, 2004, and October 11, 2004, concerning the deductibility of contributions under section 404(a) of the Internal Revenue Code ("Code") to an employee stock ownership plan ("ESOP"). Your authorized representative has submitted the following facts and representations in support of your request.

Company A, a C corporation, sponsors Plan X, which is a stock bonus plan and an ESOP as described in Code section 4975(e)(7). Company A has made loans to Plan X which are in accordance with the provisions of section 4975(d)(3) and section 54.4975-7(b) of the Excise Tax Regulations. Plan X has used the proceeds from these exempt loans to acquire shares of Company A which constitute employer securities as defined in section 409(l) of the Code. On _____, Company A entered into a loan agreement ("Loan Agreement") with Plan X to loan Plan X approximately _____ million dollars ("ESOP Loan"). Plan X used the proceeds of the ESOP Loan to purchase 480,000 shares of the common stock of Company A, all of which are pledged as security for the ESOP Loan. As a result of this purchase and the purchase of Company A stock with the proceeds of the two previous exempt loans, Plan X currently owns all of Company A's outstanding shares.

Company A proposes to contribute to Plan X _____ of the compensation otherwise paid or accrued during the taxable year to the employees under Plan X and deduct this contribution in accordance with Code section 404(a)(9)(A). Plan X will use this contribution to pay principal on the ESOP Loan. Company A also proposes to make contributions to Plan X, which will use them to pay interest on the ESOP Loan, and deduct these contributions in accordance with Code

section 404(a)(9)(B). Company A is also proposing to make an additional contribution to Plan X, not to exceed 25% of the compensation as described in section 404(a)(3), which will not be used to pay principal or interest on the ESOP Loan, and to deduct this contribution under Code section 404(a)(3), provided that the aggregate of the contributions under Code sections 404(a)(9) and 404(a)(3) does not exceed the limitations of Code section 415. All of these contributions will be made for the same year.

Company A will amend Plan X to specifically prohibit the application of any contributions made pursuant to Code section 404(a)(3) to the repayment of either principal or interest on the ESOP Loan or any other loan described in Code section 404(a)(9).

Based on the above facts and representations, your authorized representative has requested the following ruling:

Company A's proposed contribution to Plan X to pay principal on the ESOP loan will be deductible under Code section 404(a)(9)(A) and subject to its 25% limitation; Company A's proposed contribution to Plan X to pay interest on the ESOP loan will be deductible under Code section 404(a)(9)(B); and Company A's additional contributions, which will not be used to pay principal or interest on the ESOP Loan, will be deductible under Code section 404(a)(3) and subject to its 25% limitation, provided that the aggregate of the contributions under Code sections 404(a)(9) and 404(a)(3) does not exceed the limitations of Code section 415.

Code section 404(a) provides that 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, subject, however, to certain limitations as to the amounts deductible in any year.

Code section 404(a)(3)(A)(i)(I) provides in pertinent part that contributions to stock bonus and profit-sharing plans are deductible if, in the taxable year when paid, the contributions are paid into a stock bonus or profit-sharing trust, and if such taxable year ends within or with a taxable year of the trust with respect to which the trust is exempt under section 501(a), in an amount not in excess of the greater of 25 percent of the compensation otherwise paid or accrued during the taxable year to the beneficiaries under the stock bonus or profit-sharing plan.

Code section 404(a)(9)(A) states that, notwithstanding the provisions of sections 404(a)(3) and 404(a)(7), if contributions are paid into a trust which forms a part of an ESOP (as described in section 4975(e)(7)), and such contributions are, on or before the time prescribed in section 404(a)(6), applied by the plan to the repayment of the principal of a loan incurred for the purpose of acquiring qualifying employer securities (as described in section 4975(e)(8)), such contributions shall be deductible under this paragraph for the taxable year determined under section 404(a)(6). Code section 404(a)(9)(A) further provides, in pertinent part, that the amount deductible under this paragraph shall not exceed 25 percent of the compensation otherwise paid or accrued during the taxable year to the employees under such ESOP.

Code section 404(a)(9)(B) states that, notwithstanding the provisions of sections 404(a)(3) and 404(a)(7), if contributions are made to an employee stock ownership plan as described in section 404(a)(9)(A) and such contributions are applied by the plan to the repayment of interest on a loan incurred for the purpose of acquiring qualifying employer securities (as described in section 404(a)(9)(A)), such contributions shall be deductible for the taxable year with respect to which such contributions are made as determined under section 404(a)(6).

Code section 404(a)(9)(C) states that section 404(a)(9) shall not apply to an S corporation.

Code section 404(j)(1)(B) states that, in computing the amount of any deduction allowable under paragraph (1), (2), (3), (4), (7), or (9) of subsection (a) for any year in the case of a defined contribution plan, the amount of any contributions otherwise taken into account shall be reduced by any annual additions in excess of the limitation under section 415 for such year.

Code section 4975(e)(7) states that the term "employee stock ownership plan" means a defined contribution plan (A) which is a stock bonus plan which is qualified, or a stock bonus and a money purchase plan both of which are qualified under section 401(a), and which are designed to invest primarily in qualifying employer securities; and (B) which is otherwise defined in regulations prescribed by the Secretary. Section 4975(e)(7) further states that a plan shall not be treated as an employee stock ownership plan unless it meets the requirements of section 409(h), section 409(o), and, if applicable, section 409(n), section 409(p), and section 664(g) and, if the employer has a registration-type class of securities (as defined in section 409(e)(4)), it meets the requirements of section 409(e).

Code section 4975(e)(8) states in pertinent part that the term "qualifying employer securities" means any employer security within the meaning of section 409(l).

Section 54.4975-7(b)(5) of the Excise Tax Regulations provides, in part, that no person entitled to payment under the exempt loan shall have any right to assets of the ESOP other than (i) collateral given for the loan, (ii) contributions (other than contributions of employer securities) that are made under an ESOP to meet its obligations under the loan, and (iii) earnings attributable to such collateral and the investment of such contributions. The payments made with respect to an exempt loan by the ESOP during a plan year must not exceed an amount equal to the sum of such contributions and earnings 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 loan is repaid.

With respect to your requested ruling, Code section 404(a)(3) allows a deduction for contributions paid to a stock bonus plan subject to a 25 percent limit. Code section 404(a)(9)(A) allows a separate deduction for contributions applied by an ESOP to the repayment of the principal of a loan incurred for the purpose of acquiring "qualifying employer securities", subject to a 25 percent limit. Code section 404(a)(9)(B) allows a deduction for contributions applied by an ESOP to repayment of interest on such a loan. Your authorized representative has represented that the proceeds of the ESOP loan were used to purchase employer securities as

defined in Code section 409(l). A C corporation that makes contributions which are deductible under section 404(a)(9) may also make contributions which are deductible under section 404(a)(3) to the extent that such contributions are not applied by the plan to the repayment of the principal of a loan incurred for the purpose of acquiring qualifying employer securities (as described in section 4975(e)(8)), nor to the repayment of interest on such a loan. Your authorized representative has represented that Company A will amend Plan X to specifically prohibit the application of any contributions made pursuant to Code section 404(a)(3) to the repayment of either principal or interest on the ESOP Loan or any other loan incurred for the purpose of acquiring qualifying employer securities (as described in section 4975(e)(8)). The proposed cash contributions under Code section 404(a)(3) must be invested in employer securities in such a manner that Plan X will satisfy the requirement that it be primarily invested in employer securities on an ongoing basis.

Accordingly, with respect to your requested ruling, we conclude that Company A's proposed contribution to Plan X to pay principal on the ESOP loan will be deductible under Code section 404(a)(9)(A) and subject to its 25% limitation; Company A's proposed contribution to Plan X to pay interest on the ESOP loan will be deductible under Code section 404(a)(9)(B); and Company A's additional contributions, which will not be used to pay principal or interest on the ESOP Loan, will be deductible under Code section 404(a)(3) and subject to its 25% limitation, provided that the aggregate of the contributions under Code sections 404(a)(9) and 404(a)(3) does not exceed the limitations of Code section 415.

This ruling letter is based on the assumption that Plan X is qualified under Code section 401(a) and is an ESOP as described in Code section 4975(e)(7).

Furthermore, we are expressing no opinion on whether the proposed transaction described herein will affect Plan X's compliance with the requirement that it be primarily invested in employer securities on an ongoing basis.

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

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 about this letter, please contact
Please refer to SE:T:EP:RA:T3.

Sincerely yours,



Frances V. Sloan, Manager
Employee Plans Technical Group 3

Enclosures

Copy of deleted ruling

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