

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Attn: xxxxx

Contact Person: XXXXX  
Telephone Number: XXXXX  
In Reference to: OP:E:EP:T:2  
Date: DEC 2 1998

Legend:

Company M = xxxxx  
Corporation N = xxxxx  
Plan X = xxxxx  
Fund C = xxxxx

This is in response to a request dated May 21, 1998, as supplemented by correspondence dated September 4, 1998, made on your behalf by your authorized representative, for a ruling concerning the deduction under section 404(k) of the Internal Revenue Code of certain cash dividends distributed from Plan X to participants and their beneficiaries.

The following facts and representations have been submitted in support of the request:

Company M adopted Plan X on July 1, 1967. A defined contribution plan qualified under section 401(a) and 401(k) of the Code with a trust exempt under section 501(a), Plan X provides for matching contributions on both pre-tax and post-tax contributions. Such match is equal to 50 percent of the sum of an employee's pre-tax and after-tax contributions up to 6 percent of compensation. Plan X is maintained by Company M for the benefit of its employees and the employees of its adopting subsidiaries, and is administered by a Retirement Committee appointed by Company M.

As set forth in section 1.1 of the Plan document, Plan X provides for the following four types of participant Accounts: Company Contributions Account, Pre-tax Contributions Account, Post-tax Contributions Account and Rollover Contributions Account.

Plan X provides for seven kinds of investment funds. All dividends, interest and other distributions received by

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the trustee with respect to any one of the investment funds are reinvested into that same fund.

One of Plan X's investment funds is Fund C. Pursuant to section 5.1 of Plan X, Fund C is the sole vehicle for the investment of employer contributions to Plan X. Company M contributions to Plan X are invested in the capital stock of Corporation N, the parent of Company M. The capital stock of Corporation N is tradable on the NASD Exchange. The capital stock of Corporation N is referred to in Plan X as Company M stock.

Plan X was last amended and restated on January 1, 1998. Under such restatement, the following changes to Plan X will become effective January 1, 1999:

A portion of Plan X will be converted to a nonleveraged employee stock ownership plan (ESOP) that is intended to meet the requirements of sections 401(a), 409 and 4975(e)(7) of the Code;

Fund C will be divided into an ESOP subaccount and a nonESOP subaccount;

Fund C will be available for investment of pre-tax contributions, post-tax contributions and rollover contributions as well as for employer contributions;

Each of the four types of participant Accounts will be divided into an ESOP subaccount and a nonESOP subaccount. For instance, every Post-tax Contributions Account maintained on behalf of individual participants will be divided into ESOP and NonESOP subaccounts; and

The ESOP will consist of the Fund C ESOP subaccount. The Fund C ESOP subaccount will be the sum of all amounts held in the Company Contributions Account ESOP subaccount, Pre-tax Contributions Account ESOP subaccount, Post-tax Contributions Account ESOP subaccount and Rollover Contributions Account ESOP subaccount.

Participants or their beneficiaries will be able to elect to receive cash distributions of dividends paid on Company M stock in the ESOP subaccount of Fund C. Such election is to be made at such time and in such manner as the Retirement Committee may prescribe and is effective for the distribution of future cash dividends until the election is revoked by the participant or beneficiary. If a participant or beneficiary elects to receive cash, the cash dividend will be paid by the dividend disbursing agent directly to the Plan trustee and then distributed by the trustee to the participant or beneficiary no later than 90

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days after the end of the plan year in which the dividend is declared. The plan year of Plan X is based on the calendar year.

Based on the above facts and representations, you have requested a ruling that dividends on Company M stock held by the ESOP portion of Plan X that are paid directly in cash to participants or beneficiaries or to the Trustee and then distributed to participants or beneficiaries within 90 days of the close of the plan year, will be deductible under section 404(k) of the Code by Company M in the year in which such dividends are paid or distributed to participants or beneficiaries.

Section 404(k)(1) of the Code provides that, in the case of a corporation, there shall be allowed as a deduction for a taxable year the amount of any applicable dividend paid in cash by such corporation during the taxable year with respect to applicable employer securities. Such deduction is in addition to the deductions allowed under section 404(a) of the Code.

Section 404(k)(2) of the Code provides, in relevant part, that the term "applicable dividend" means any dividend which, in accordance with the plan provisions, is paid in cash to plan participants or their beneficiaries or is paid to the plan and is distributed in cash to plan participants or their beneficiaries not later than 90 days after the close of the plan year in which paid.

Section 404(k)(3) of the Code provides, in relevant part, that the term "applicable employer securities" means, with respect to any dividend, employer securities which are held on the record date for such dividend by an ESOP which is maintained by

- (a) the corporation paying such dividend or
- (b) any other corporation which is a member of a controlled group of corporations (within the meaning of section 409(e)(4) of the Code which includes such corporation.

Section 404(k)(6)(A) of the Code provides that for purposes of section 404(k), "employer securities" has the meaning given such term by section 409(1) of the Code.

Section 409(1) of the Code provides that the term "employer securities" means common stock issued by the employer (or by a corporation that is a member of the same controlled group) which is readily tradable on an established securities market.

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Section 404(k)-1T, Q&A-1 of the Temporary Income Tax Regulations provides that section 404(k) of the Code allows a corporation a deduction for dividends actually paid in accordance with section 404(k)(2) with respect to stock of such corporation held by an ESOP (as defined in section 4975(e)(7) of the Code maintained by the corporation (or by any other corporation that is a member of a "controlled group of corporations", within the meaning of section 409(l)(4) of the Code, that includes the corporation), but only if such dividends may be immediately distributed under the terms of the plan and all of the applicable qualification and distribution rules. The deduction is allowed under section 404(k) for the taxable year of the corporation during which the dividends are received by the participants.

Section 404(k)-1T, Q&A-2 of the Temporary Income Tax Regulations provides that the deductibility of dividends paid to plan participants under section 404(k) of the Code is not affected by a plan provision which permits participants to elect to receive or not receive payment of dividends. Dividends actually paid in cash to plan participants in accordance with section 404(k) of the Code are deductible under section 404(k) despite such an election provision.

Section 404(k)(5)(A) of the Code provides that the Secretary may disallow the deduction under section 404(k)(1) for any dividend if the Secretary determines that such dividend constitutes, in substance, an evasion of taxation.

Based on your representations, Corporation N and Company M are members of the same controlled group; contributions to the ESOP portion of Plan X will be invested in the common stock of Corporation N; the common stock of Corporation N is readily tradable on an established securities market; and dividends on Corporation N stock allocated to participants' ESOP subaccounts will be paid to participants or beneficiaries within 90 days of the close of the plan year, if they do not elect to have the dividends retained by Plan X.

Accordingly, we conclude that dividends on Company M stock held by the ESOP portion of Plan X that are paid directly in cash to participants or beneficiaries or to the Trustee and then distributed to participants or beneficiaries within 90 days of the close of the plan year, will be deductible under section 404(k) of the Code by Company M in the year in which such dividends are paid or distributed to participants or beneficiaries.

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This ruling is based on the assumption that Plan X will meet the requirements of sections 401(a), 401(k), 409(l) and 4975(e)(7) of the Code and that the related trust will be tax exempt under section 501(a) at the time the transaction that you have described takes place.

This ruling is also based on the assumption that the proposed dividends do not constitute, in substance, an evasion of taxation within the meaning of section 404(k)(5)(A) of the Code. We are expressing no opinion as to whether or not the disallowance of deductions provided for in that section would be applicable here.

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

Sincerely,

**(signed) JOYCE E. FLOYD**

Joyce E. Floyd  
Chief, Employee Plans  
Technical Branch 2

Enclosures:

Deleted Copy of this letter  
Notice of Intention to Disclose

cc:

District Director  
XXXXXX Key District  
Attn: Chief, EP/EO

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