

Internal Revenue Service  
**memorandum**

CC:EE:TR-45-2181-95  
Br5:JTRicotta

date: NOV 6 1995

to: Director, Employee Plans Technical and Actuarial Division  
(CP:E:EP)

from: Chief, <sup>JLB</sup> Branch 5 (CC:EBEO) Room 5229

subject: [REDACTED]

This responds to your request for technical assistance regarding the taxpayer's third ruling request in the above-captioned case as it relates to eligibility for the partial interest exclusion of section 133. The taxpayers have requested several rulings concerning the refinancing of an ESOP loan transaction.

In 1989, the ESOP purchased shares of [REDACTED] (the Company). The ESOP's purchase was financed through three different loans. First, the Company engaged in back-to-back loans with the ESOP, borrowing \$ [REDACTED] from an institutional lender (Outside Loan) and lending that amount to the ESOP (Inside Loan). Both the Inside and Outside loans have a term of 6.7 years. The second component of the financing was a direct loan of \$ [REDACTED] from an institutional investor to the ESOP with a term of 10.7 years. The third component of the financing involved the ESOP's issuance of \$ [REDACTED] in variable rate notes with a maturity date of December 31, 2008.

The company proposes to refinance the back-to-back loan component by having the ESOP borrow from the company an amount equal to the outstanding principal balance on the Inside Loan on the maturity date of February 28, 1996. The new Inside loan would have a maturity of December 31, 2008. At the same time, the company would refinance the Outside Loan through a new loan with the same maturity date. Neither the new inside loan nor the new outside loan will qualify for the partial interest exclusion of section 133.

The taxpayer has requested a ruling that the partial excludability under section 133 for interest paid on the original outside loan under the back-to-back arrangement from inception to maturity will not be adversely affected by the prepayment of the new outside loan without repayment of the new inside loan.

Section 133(a) of the Code provides that gross income does not include fifty percent of the interest received or accrued by (1) a bank (within the meaning of section 581); (2) an insurance company to which subchapter L applies; (3) a corporation actively

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engaged in the business of lending money; or (4) a regulated investment company (as defined in section 851), with respect to a securities acquisition loan.

A securities acquisition loan is any loan to a corporation or an ESOP (as defined in section 4975(e)(7)) that qualifies as an exempt loan under sections 54.4975-7 and -11 of the Excise Tax Regulations to the extent that the proceeds are used to acquire employer securities (within the meaning of section 409(1)) for the ESOP. Section 1.133-1T of the Income Tax Regulations, section 133(b)(1). The term "securities acquisition loan" shall not include a loan with a term greater than 15 years. Section 133(b)(3) provides that a loan to a corporation shall not fail to be treated as a securities acquisition loan merely because the proceeds of such loan are lent to an ESOP sponsored by such corporation if such loan includes repayment terms which are substantially similar to the terms of the loan of such corporation from a lender described in subsection (a), or repayment terms providing for more rapid repayment of principal or interest on such loan, but only if allocations under the plan attributable to such repayment do not discriminate in favor of highly compensated employees (within the meaning of section 414(q)).

Therefore, with respect to your third ruling request, we conclude that the partial excludability under section 133 for interest paid on the original outside loan under the back-to-back arrangement from inception until maturity will not be adversely affected by the prepayment of the new outside loan without corresponding prepayment of the new inside loan.

Also see comment on page 3 of the draft ruling. If you have further questions concerning this case, please contact John Ricotta at 622-6080.