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TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Uniform Issue List 402.07-00

DEC - 8 2004

T:EP:RA:T3

LEGEND:

Company A:

Company B:

Company C:

Company D:

Company E:

Plan X:

Plan Y:

Dear

This is in response to a request for a private letter ruling dated December 27, 2002, as supplemented by correspondence dated May 1, 2003, May 12, 2003, June 30, 2003, October 21, 2003, and November 29, 2004, submitted on your behalf by your authorized representative, concerning the determination of net unrealized appreciation under section 402(j) of the Internal Revenue Code ("Code"). In support of your request, your authorized representative has presented the following facts and representations:

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Company A was incorporated on _____, as a wholly-owned subsidiary of Company B. Company A provides _____ and _____. Effective _____, Company C became a wholly-owned subsidiary of Company B through a merger agreement in which a wholly-owned subsidiary of Company B merged with and into Company C ("Merger 1"). Following the merger, the separate corporate existence of the merger subsidiary ceased. In connection with the merger, Company B changed its name to Company D. On _____, the assets and liabilities of the business operations of the former _____ division of Company D were transferred to Company A, which is essentially a continuation of that division.

In _____, Company A made an initial public offering of approximately _____ percent of its issued and outstanding shares. In _____, Company D approved a plan to spin off to its shareholders the remaining shares of Company A stock held by Company D. The spin-off occurred on _____. As a result, holders of Company D stock also became holders of Company A stock.

On _____, Company D entered into an agreement and plan of merger ("Merger 2") with Company E and a wholly-owned subsidiary of Company E, formed for the purpose of the merger. The effective date of Merger 2 was _____. Under the terms of Merger 2, this subsidiary merged with and into Company D, resulting in Company D becoming a wholly-owned subsidiary of Company E upon completion of the merger. In connection with Merger 2, Company E exchanged _____ shares of Company E common stock for each outstanding share of Company D common stock.

Company B established Plan Y effective _____. As a result Merger 1, Plan Y is now sponsored by Company D. Plan Y is qualified under Code section 401(a) and includes a leveraged employee stock ownership plan (ESOP). Plan Y holds Company D common stock through the ESOP and also through the self-directed investments of plan participants.

As part of the transfer of the _____ division described above, employees who worked in this division were transferred to Company A and its subsidiaries. Prior to _____, the transferred employees participated in Plan Y. Effective _____, the assets of Plan Y allocated to the accounts of these participants (and certain terminated participants) were transferred to a successor plan, Plan X, which was established effective _____. A portion of the unallocated assets and liabilities of the Plan Y ESOP was also transferred to Plan X. Plan X is a defined contribution plan intended to qualify under Code section 401(a) and contains a leveraged ESOP that is intended to be an ESOP within the meaning of Code section 4975(e)(7).

Prior to the spin-off of Company A on _____, employer matching contributions to Plan X were automatically invested in the Company D stock, subject to certain Plan X diversification provisions. Participants could also self-direct their own contributions into Company D stock. As a result of the spin-off, Plan X held shares of Company D common stock and shares of Company A.

Beginning on _____, employer matching contributions to Plan X are automatically invested in Company A common stock, subject to certain Plan X diversification provisions.

Participants may also self-direct their own contributions into Company A common stock. Participants may continue to keep a portion of their accounts invested in Company D common stock or they may change all of any part of their investments to other funds available for transfers under Plan X. However, no contributions made to Plan X on or after _____ may be invested in the Company D stock fund and no amount invested in the other investment funds under Plan X may be transferred to the Company D stock fund. Any dividends paid on the Company D common stock are allocated to the Company A stock fund set up for employee contributions.

As described above, pursuant to the merger of Company D and Company E, shares of Company E common stock will be exchanged for shares of Company D common stock. Thus, following the merger, Plan X will hold Company E shares in place of Company D shares. Company E shares held by Plan X will be subject to the same rules as currently apply to Company D shares. Participants will not be permitted to invest additional amounts in Company E shares and dividends paid on Company E shares will be invested in Company A stock. Under the terms of Plan X, participants may, by giving instructions to the recordkeeper of Plan X, direct the trustee of Plan X to dispose of their investments in the Company E common stock fund and reinvest the proceeds in the Company A common stock fund.

Plan X's suspense account presently holds only stock of Company A, together with a small amount of other short-term investments.

Based on the foregoing facts and representations, your authorized representatives have requested the following ruling:

Under Code section 402(j), a transaction will be disregarded for purposes of determining net unrealized appreciation, where, at the direction of the participant, the plan trustee disposes of all or a portion of the participant's investment in Company E common stock and uses the proceeds to invest in Company A common stock, provided that the reinvestment in Company A common stock occurs within 90 days of the disposition of Company E common stock.

Code section 402(a)(1) states that, except as provided in this section, any amount actually distributed to any distributee by any employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to the distributee, in the taxable year of the distributee in which distributed, under section 72 (relating to annuities).

Code section 402(e)(4)(A) states in pertinent part that, for purposes of sections 402(a) and 72, in the case of a distribution other than a lump sum distribution, the amount actually distributed to any distributee from a trust described in section 402(a) shall not include any net unrealized appreciation in securities of the employer corporation attributable to amounts contributed by the employee.

Code section 402(e)(4)(B) states in pertinent part that, for purposes of sections 402(a) and 72, in the case of any lump sum distribution which includes securities of the employer corporation, there shall be excluded from gross income the net unrealized appreciation attributable to that part of the distribution which consists of securities of the employer corporation.

Code section 402(e)(4)(E)(ii) provides in pertinent part that, for purposes of section 402(e), the term "securities of the employer corporation" includes securities of a parent or subsidiary corporation (as defined in subsections (e) and (f) of Code section 424) of the employer corporation.

Code section 402(j) provides a special rule for certain transactions. Section 402(j) states, that for section 402(e)(4) purposes, the determinations of net unrealized appreciation will not apply to transactions where a plan trustee disposes of securities of the employer corporation and uses the proceeds of such disposition to acquire securities of the employer corporation within 90 days.

Section 1.402(a)-1(b)(2)(i) of the Income Tax Regulations provides that the amount of net unrealized appreciation in securities of the employer corporation which are distributed by the trust is the excess of the market value of such securities at the time of distribution over the cost or other basis of such securities to the trust. Section 1.402(a)-1(b)(2)(ii) of the regulations sets forth the manner in which the cost or other basis to the trust of a distributed security of the employer corporation is calculated for purposes of determining the net unrealized appreciation on such security.

We previously ruled, in a letter dated July 9, 2003, that the shares of Company E common stock that will be acquired by Plan X in connection with the merger of Company E and Company D will be "securities of the employer corporation" for purposes of Code section 402(e)(4).

Code section 402(j), by its terms alone, does not expressly prohibit participant-directed transactions. Further, the legislative history (*see*, Senate Report No. 99-313, at 1040 (1986)) indicates that section 402(j) applies to transactions that are in the exercise of fiduciary duty or are required by the Employee Retirement Income Security Act of 1974 ("ERISA"), and ERISA requires a participant-directed trustee to act in accordance with participant investment directions. Therefore, it is appropriate for participant-directed dispositions and acquisitions of employer securities to be covered by section 402(j), provided that the transactions are completed within the required time frame.

Accordingly, we conclude with respect to your requested ruling that, under Code section 402(j), a transaction will be disregarded for purposes of determining net unrealized appreciation, where, at the direction of the participant, the plan trustee disposes of all or a portion of the participant's investment in Company E common stock and uses the proceeds to invest in Company A common stock, provided that the reinvestment in Company A common stock occurs within 90 days of the disposition of Company E common stock.

This ruling letter is based on the assumption that Plan X will be qualified under Code section 401(a) and that the Plan X ESOP will meet the requirements of section 4975(e)(7), and that its related trust will be tax-exempt under section 501(a) at all times relevant to the transactions described herein.

This ruling letter is also based on the assumption that the merger of Company D with Company E constitutes a reorganization as described in Code section 368(a).

In accordance with Code section 402(j)(2)(b), this ruling letter does not apply to any employee with respect to whom a distribution of money was made during the period after such disposition and before such acquisition. Further, for the purposes of this ruling letter, the term "securities" is limited to those instruments described in Code section 402(e)(4)(E)(i) and section 1.402(a)-1(b)(1)(ii) of the regulations and expressly does not apply to contracts providing an employee the option to purchase employer securities.

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.

If you have any questions about this letter, please contact
Please refer to SE:T:EP:RA:T:3.

Copies of this letter have been sent to your authorized representatives in accordance with the power of attorney on file in this office.

Sincerely yours,



Frances V. Sloan, Manager
Employee Plans Technical Group 3

Enclosures
Notice 437
Deleted copy of ruling letter

Cc: