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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

JUL 09 2003

Uniform Issue List 402.01-00

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 two letters dated April 14, 2003, a letter dated May 12, 2003, and a letter dated June 30, 2003, submitted on your behalf by your authorized representative, concerning the status of certain securities held by Plan X under section 402(e)(4) of the Internal Revenue Code ("Code"). Additional correspondence dated June 11 and 16, 2003, was also submitted.

In support of your request, your authorized representative has presented the following facts and representations:

Company A was incorporated on , as a wholly-owned subsidiary of Company B. Company A provides . 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 the merger 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 of 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 reallocate 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.

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:

1. 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). Accordingly, the net unrealized appreciation in such shares may be excluded from gross income upon distribution to a participant or beneficiary to the extent provided in Code section 402(e)(4).

Your second requested ruling was withdrawn by your authorized representative in a letter dated July 8, 2003. Your third requested ruling will be addressed in later correspondence. Your fourth requested ruling is rendered moot by our response to your first requested ruling.

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) states that the term "securities of the employer corporation" includes securities of a parent or subsidiary corporation (as defined in subsections (e) and (f) of section 424) of the employer corporation.

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.

In Revenue Ruling 73-29, 1973-1 C.B. 198, securities of an employer corporation held by its qualified trust were transferred to the qualified trust of an unrelated corporation when the first employer sold part of its business and transferred some of its employees to the unrelated corporation. It was held that shares of stock of the seller corporation distributed from the buyer's qualified trust to employees of the buyer corporation who were former employees of the seller corporation were securities of the employer corporation and will retain their character of employer securities even after those shares and the employees on whose account they were held were transferred to the unrelated corporation.

In Revenue Ruling 73-312, 1973-2 C.B. 142, securities of an employer corporation held by its qualified trust were exchanged for securities of a successor corporation when the employer corporation merged into the successor corporation. The plan was then terminated and distributions were made to participants. It was held that the stock of the predecessor corporation was held or acquired by the exempt trust while the employees were covered under the predecessor corporation's plan. Thus, it was further held that this stock was stock of the employer corporation within the meaning of Code section 402(a), and would have been so treated if it had been distributed to the employees after the merger. The revenue ruling states

that the mere conversion of the stock into stock of the successor corporation did not change its status as stock of the employer within the meaning of Code section 402(a)(1).

In the present case, Plan X holds Company D common stock. Plan X's predecessor plan, Plan Y, was sponsored by Company D for the benefit of its employees and thus the shares of Company D stock held in Plan Y were employer securities. In accordance with Code section 402(e)(4)(E)(ii), we have determined that these shares remained employer securities upon their transfer to Plan X, maintained by Company D's wholly-owned subsidiary Company A, as described above. We have also determined that the subsequent spin-off of Company A from Company D did not affect the status of Company D stock as employer securities because they were employer securities when acquired by Plan X (*see* Rev. Rul. 73-29).

The issue presented here is whether the Company E shares received as a result of the merger of Company D and Company E should be treated as employer securities.

The principles underlying the revenue rulings discussed above are applicable here. In both rulings, the status of stock as employer securities was not affected by corporate transactions that resulted in a qualified plan holding stock of a former employer. The mere conversion of employer securities (Company D stock) into the stock of its merger partner (Company E) will not change its status as stock of the employer within the meaning of Code section 402(e)(4).

Accordingly, we conclude with respect to your first requested ruling 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). Accordingly, the net unrealized appreciation in such shares may be excluded from gross income upon distribution to a participant or beneficiary to the extent provided in Code section 402(e)(4).

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.

No opinion is expressed about the tax treatment of the transactions under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the above rulings.

In particular, we are not expressing any opinion relating to the calculation of basis for purposes of determining net unrealized appreciation under Code section 402(e)(4).

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 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

Frances V. Sloan, Manager
Employee Plans Technical Branch 3

Enclosures
Notice 437
Deleted copy of ruling letter

Cc: