MEMORANDUM FOR DANIEL R. JONES, MANAGER, EP DETERMINATIONS QUALITY ASSURANCE

FROM: JoAnna H. Weber, Acting Director, Employee Plans Rulings and Agreements

SUBJECT: Response to Technical Assistance Request (#4)

This memorandum is in response to your Request for Technical Assistance, dated April 3, 2009, with regard to rebalancing and reshuffling provisions in employee stock ownership plans ("ESOPs") (within the meaning of Internal Revenue Code ("Code") section 4975(e)(7)) and stock bonus plans. The guidance in this memorandum is to be used to determine appropriate plan language. Please contact us if additional guidance is needed with respect to specific plan provisions.

Issues:

1) Whether an ESOP or stock bonus plan can include a reshuffling provision which allows a trustee, fiduciary, and/or administrator, at its discretion, to involuntarily exchange employer stock held in the account of one or more participants for cash or other assets allocated to the accounts of one or more plan participants in view of several potential violations of law that may arise from the implementation of such provisions. Specifically, does the transfer of assets pursuant to a reshuffling provision cause the plan to operate in violation of sections 1.401-1(b)(1)(i), (ii) or (iii) of the Income Tax Regulations ("Regulations") and Revenue Ruling 80-155, respectively, by contravening prior allocations to participant accounts of 1) employer contributions, in cash or employer stock, and 2) earnings on trust assets?

2) Whether an involuntary transfer of assets made in accordance with a reshuffling provision violates the diversification requirements of Code sections 401(a)(28) and 401(a)(35) and/or plan provisions for voluntary self-direction of participant accounts by altering prior allocations of cash, stock and other assets made by the trustee, fiduciary or administrator at the instruction of the participant.

3) Whether the establishment and implementation of a reshuffling provision is consistent with the fundamental nature of how trusts under a defined contribution plan are structured and operated. With the exception of participant self-directed accounts, which hold assets segregated from assets of the general trust in an

account established in the name of the participant, amounts held in the accounts of other participants merely reflect the value of trust assets which are allocated to such accounts for bookkeeping purposes. Assets allocated to these accounts can be acquired, invested or disposed at the discretion of the trustee, fiduciary and/or administrator, subject to trust provisions and the fiduciary standards of the Employee Retirement Income Security Act ("ERISA"). In light of the foregoing, the trustee or administrator is at liberty to engage in transactions involving employer stock, cash or other assets held in the general trust fund without having to adjust allocations to participant accounts to reflect exchanges of assets between the accounts in accordance with a reshuffling provision.

4) Whether a reshuffling provision which operates to contravene a prior allocation of stock made to a participant's account in the form of an employer contribution to the plan or an allocation to a self-directed account pursuant to written instructions from the participant will cause the plan to:

   a. violate the current and effective availability requirements of section 1.401(a)(4)-4 of the Regulations with respect to the right of a participant to retain the employer stock held in his or her account and participate in the growth of stock value, unless and until the stock is distributed to the participant upon the occurrence of a distributable event, including an election made by an eligible participant in accordance with Code section 401(a)(28)(B); or

   b. violate the current and effective availability requirements of section 1.401(a)(4)-4 of the Regulations with respect to the right of a participant to a particular form of investment when assets transferred to and from a participant's account pursuant to a diversification election made in accordance with Code sections 401(a)(28) and 401(a)(35) and/or plan provisions for voluntary self-direction of assets held in participant accounts are removed from the account by application of a reshuffling provision.

5) Whether the transfer of stock from a self-directed participant's account in accordance with a reshuffling provision causes the plan to violate Code section 411(a)(11) by placing a significant detriment on a participant who elects to defer a distribution until it is no longer immediately distributable by denying the participant the opportunity to choose among investment alternatives with materially different risk and reward characteristics. Refer to section 1.411(a)-11(c)(2) of the Regulations and Rev. Rul. 96-47.

Example Plan Language

1) *The Trustee may debit a Participant's Company Stock Subaccount with one type of Employer Securities provided the Trustee credits such Participant's Company stock Subaccount with another type of Employer Securities equal in fair market value as*

determined by the Independent Appraiser as of such date. The Trustee may debit a Participant's Company Stock Subaccount provided the Trustee credits such Participant's Other Investments Subaccount on the date of such debit with assets equal to the fair market value of the Employer Securities debited as determined by the Independent Appraiser of such date.

2) *Required Divestiture for Participants Who Have Attained the Age of 60: The Trustee shall transfer from a Participant's account the Employer stock in such Participants account in accordance with the following schedule:*

Attained Age	*Fraction of Stock to be Transferred*
60	*1/8*
61	*1/7*
62	*1/6*
63	*1/5*
64	*¼*
65	*1/3*
66	*½*
67	*100%*

The transfer of the stock in the Participant's account shall be made internally within the Plan or sold by the Plan. The consideration to the Participant's account shall be the fair market value of the stock as of the date of such transfer. Once the transfers take place, the Participant shall be entitled to direct the investment of the Participant's non-stock account in accordance with the provisions of 9.15.

Background and General Statement of the Law:

Code section 4975(e)(7) provides 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. 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, as 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 401(a)(23) provides that a stock bonus plan shall not be treated as meeting the requirements of section 401(a) unless such plan meets the requirements of subsections (h) and (o) of section 409, except that in applying section 409(h) for purposes of this paragraph, the term "employer securities" shall include any securities of the employer held by the plan.

Section 1.401-1(a)(2) of the Regulations provides that a qualified pension, profit-sharing, or stock bonus plan is a definite written program and arrangement which is communicated to the employees and which is established and maintained by an employer.

Section 1.401-1(b)(1)(ii) of the Regulations provides that a profit-sharing plan must provide a definite predetermined formula for allocating the contributions made to the plan among the participants and for distributing the funds accumulated under the plan after a fixed number of years, the attainment of a stated age, or upon the prior occurrence of some event such as layoff, illness, disability, retirement, death, or severance of employment. A formula for allocating the contributions among the participants is definite if, for example, it provides for an allocation in proportion to the basic compensation of each participant.

Section 1.401-1(b)(1)(iii) of the Regulations provides that a stock bonus plan is a plan established and maintained by an employer to provide benefits similar to those of a profit-sharing plan, except that the benefits are distributable in stock of the employer company. For the purpose of allocating and distributing the stock of the employer which is to be shared among his employees or their beneficiaries, such a plan is subject to the same requirements as a profit-sharing plan. See also Code section 409(h)(2) for special rules applicable to ESOPs (via Code section 4975(e)(7)) and to stock bonus plans (via Code section 401(a)(23)).

Code section 411(d)(6) provides that a plan amendment may not decrease a participant's accrued benefit.

Section 1.411(d)-4, A-1(d) of the Regulations provides that the right to a particular form of investment (e.g., investment in employer stock or securities or investment in certain types of securities, commercial paper, or other investment media) is not a section 411(d)(6) protected benefit.

Code section 401(a)(4) provides that a trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section if the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees ("HCEs") (within the meaning of Code section 414(q)).

Section 1.401(a)(4)-4 of the Regulations provides rules for determining whether the benefits, rights, and features provided under a plan (i.e., all optional forms of benefit, ancillary benefits, and other rights and features available to any employee under the plan) are made available in a nondiscriminatory manner. Benefits, rights, and features provided under a plan are made available to employees in a nondiscriminatory manner only if each benefit, right, or feature satisfies the current availability requirement and the effective availability requirement of this section.

Section 1.401(a)(4)-4(b) of the Regulations provides that the current availability requirement is satisfied if the group of employees to whom a benefit, right, or feature is currently available during the plan year satisfies section 410(b) (without regard to the average benefit percentage test of § 1.410(b)-5).

Section 1.401(a)(4)-4(b)(2) of the Regulations provides that whether a benefit, right, or feature that is subject to specified eligibility conditions is currently available to an employee generally is determined based on the current facts and circumstances with respect to the employee.

Section 1.401(a)(4)-4(c) of the Regulations provides that the effective availability requirement is satisfied if, based on all of the relevant facts and circumstances, the group of employees to whom a benefit, right, or feature is effectively available does not substantially favor HCEs.

Section 1.401(a)(4)-4(d)(6) of the Regulations, which provides special rules for ESOPs, states that an ESOP does not fail to satisfy the current availability and effective availability requirements merely because it makes an investment diversification right or feature or a distribution option available solely to all qualified participants (within the meaning of section 401(a)(28)(B)(iii)), or merely because the restrictions of section 409(n) apply to certain individuals.

Section 1.401(a)(4)-4(e)(3)(i) of the Regulations defines "other right or feature," in general, to mean any right or feature applicable to employees under the plan. Different rights or features exist if a right or feature is not available on substantially the same terms as another right or feature.

Section 1.401(a)(4)-4(e)(3)(iii) of the Regulations provides that "other rights and features" include, but are not limited to, the right to direct investments and the right to a particular form of investment including, for example, a particular class or type of employer securities (taking into account, in determining whether different forms of investment exist, any differences in conversion, dividend, voting, liquidation preference, or other rights conferred under the security).

Section 1.401(a)(4)-10 of the Regulations provides the rules for applying the nondiscrimination requirements of Code section 401(a)(4) to former employees. A plan satisfies section 401(a)(4) with respect to the availability of benefits, rights and features provided to former employees if any change in the availability of any benefit, right or feature to any former employee is applied in a manner that, under all the facts and circumstances, does not discriminate significantly in favor of former HCEs.

Code section 401(a)(28)(B)(i) provides that a trust which is part of an employee stock ownership plan (within the meaning of section 4975(e)(7)) or a plan which meets the requirements of section 409(a) shall not constitute a qualified trust under this section unless each qualified participant in the plan may elect within 90 days after the close of each plan year in the qualified election period to direct the plan as to the investment of at least 25 percent of the participant's account in the plan (to the extent such portion exceeds the amount to which a prior election under this subparagraph applies). In the case of the election year in which the participant can make his last election, the preceding sentence shall be applied by substituting “50 percent” for “25 percent.”

Code section 401(a)(28)(B)(ii) provides that a plan meets the above requirement if:
(I) the portion of the participant’s account covered by the election under clause (i) is distributed within 90 days after the period during which the election may be made, or
(II) the plan offers at least 3 investment options (not inconsistent with Regulations prescribed by the Secretary) to each participant making an election under clause (i) and within 90 days after the period during which the election may be made, the plan invests the portion of the participant's account covered by the election in accordance with such election.

Code section 401(a)(35) provides that a trust which is part of an applicable defined contribution plan shall not be treated as a qualified trust unless the plan meets the following diversification requirements: (1) participants may divest employer securities in their accounts attributable to employee contributions and elective deferrals, and reinvest an equivalent amount in investment options described below; (2) participants who have completed at least 3 years of service and their beneficiaries (or beneficiaries of deceased participants) may divest employer securities attributable to elective deferrals and reinvest an equivalent amount in the investment options described below, and (3) the plan must provide at least 3 investment options other than employer securities that are diversified and have materially different risk and return characteristics.

Code section 411(a)(11) provides the consent requirements that must be satisfied with respect to certain distributions in order for the plan to qualify under section 401(a).

Code section 411(a)(11)(A) provides that if the present value of any nonforfeitable accrued benefit exceeds $5,000, a plan meets the requirements of this paragraph only if such plan provides that such benefit may not be immediately distributed without the consent of the participant.

Section 1.411(a)-11(c)(2)(i) of the Regulations provides that a consent to a distribution is not valid if a significant detriment is imposed under the plan on any participant who does not consent to a distribution. This section further provides that whether or not a significant detriment is imposed shall be determined by examining the particular facts and circumstances.

Revenue Ruling 96-47, 1996-2 C.B. 35, involved a profit-sharing plan that allowed participants to choose among a broad range of investment alternatives in directing the investment of their accounts, but restricted terminated participants who did not elect an immediate distribution to investing their accounts in a money market fund. The revenue ruling concluded that the loss of the right to choose among a broad range of investments is a significant detriment under section 1.411(a)-11(c)(2)(i) of the Regulations imposed on a participant who does not consent to a distribution.

Analysis and Conclusion:

For purposes of our analysis, we define “rebalancing” as the mandatory transfer of employer securities into and out of participant plan accounts, usually on an annual basis, designed to result in all participant accounts having the same proportion of employer securities. A plan provision that allows participants to opt out of such mandatory transfers is not a rebalancing provision, but is rather a provision providing for participant-directed investment elections. “Reshuffling” is the mandatory transfer of employer securities into or out of plan accounts, not designed to result in an equal proportion of employer securities in each account.

As stated in section 1.411(d)-4 of the Regulations, the right to a particular form of investment (e.g., investment in employer stock or securities) is not a section 411(d)(6) protected benefit. Accordingly, plan provisions may provide for rebalancing or reshuffling, subject to the limitations set forth below.

Any plan provision providing for the mandatory transfer of stock must meet the requirements of section 1.401-1(a)(2) of the Regulations (for a “definite written program”) as well as sections 1.401-1(b)(1)(ii) and (iii) (requiring a definite predetermined allocation formula). Thus, in general, the provision must have language that directs the plan administrator as to the number of shares or amount of cash to transfer in or out of plan accounts. In addition, the plan must state the manner in which the transfers will be effectuated, such as the date of valuation.

In addition, the right of each participant to have or not have a particular form of investment in his or her account is a plan right or feature that is subject to the current and effective availability requirements of section 1.401(a)(4)-4 of the Regulations. Any plan provision that raises issues of current or effective availability in form may be considered inappropriate. Plans must also meet these requirements in operation. Rebalancing, which treats all participants the same, will not raise issues of current and effective availability. Because terminated employees comprise a coverage group under section 1.401(a)(4)-10, a plan provision providing for the transfer of all employer securities from plan accounts of terminated employees also does not raise issues of current or effective availability in form. However, see our response to issue #5 below, where we discuss the application of section 1.411(a)-11(c)(2) of the Regulations to this provision. Further, a reshuffling provision will not fail to satisfy section 1.401(a)(4)-4 in form merely because it imposes age or service conditions on the availability of an investment option.

The right to retain employer securities is not a protected benefit under section 411(d)(6), but the diversification rights in sections 401(a)(28)(B) and 401(a)(35) include a participant’s right not to have shares diversified pursuant to such sections mandatorily transferred back into his or her account. As a result, any rebalancing or reshuffling provision must preclude shares diversified under sections 401(a)(28)(B) or 401(a)(35) from being mandatorily returned to participants’ accounts.

Applying these principles to the two examples, the plan language in Example 1 would fail to satisfy section 1.401-1(b)(1) of the Regulations because it allows the Trustee discretion over which participants' accounts receive ESOP shares and which accounts are divested of their shares.[1]

The language in Example 2, on the other hand, provides a definite formula by which employer stock will be transferred from participants' accounts: starting at age 60, a fraction of a participant's employer stock is transferred out of his or her account; this fraction increases each year until the participant reaches age 67, at which time the percentage is 100%. However, regarding the accounts indirectly affected by this provision (i.e. accounts of participants who have not attained age 60), the provision needs language providing the Trustee with a method for determining which of these participants' accounts, if any, will receive employer securities. For example, the plan could specify that transfers will occur pro rata, based on the amount of employer securities in the account of each participant under the age of 60. The provision in Example 2 does not raise any issues of current or effective availability in form. However, this provision raises concerns of potential violation of Code section 411(b)(2)(A) (relating to age discrimination in allocations), but we would at this time recommend against requiring this provision to be removed (or made elective) in light of the absence of authority to support the conclusion that, for purposes of Code section 411(b)(2)(A), the allocation rate includes investment options. Note that if this provision provided for mandatory transfers of employer stock into participant accounts, it must also preclude the mandatory transfer of shares diversified pursuant to sections 401(a)(28)(B) or 401(a)(35) back into a participant's account.

We conclude as follows to the specific questions raised:

1) As explained above, we agree that a reshuffling provision such as that in Example 1 that affords an administrator discretion to choose which participants will receive or transfer shares violates section 1.401-1(b)(1) of the Regulations.

2) As to whether rebalancing or reshuffling violates Code sections 401(a)(28)(B) and 401(a)(35), our view is that it does not, so long as the rebalancing or reshuffling is carried out within the parameters discussed above. Both Code provisions require ESOPs (and in the case of section 401(a)(35), stock bonus plans) to allow participants to diversify the shares in their accounts that are invested in employer securities, but neither section prohibits mandatory transfers. As mentioned above, however, the plan may not mandatorily reinvest a participant's shares in employer securities after the participant has diversified those shares pursuant to sections 401(a)(28)(B) and 401(a)(35).

3) In order to comply with various requirements for ESOPs and other stock bonus plans, an administrator needs to keep track of the number of shares in each participant's account. For example, to comply with sections 401(a)(28)(B) (in the case of ESOPs) and

[1] It may be argued that this provision might be appropriate if it were limited by its language to actions taken by the plan administrator that relate to specific fiduciary obligations under section 404(a)(1) of ERISA. Should this become an issue, please discuss with us.

section 401(a)(35) (in the case of certain ESOPs and stock bonus plans), the administrator must determine the total shares in a participant's account so as to provide the participant with the ability to diversify employer securities in his or her account. Similarly, section 409(p) requires that an ESOP administrator have the ability to calculate a participant's number of deemed-owned shares. Accordingly, any stock transactions must necessarily result in adjustment of the stock allocations in individual accounts.

4) As previously stated, plans may provide for the rebalancing and reshuffling of employer securities held in participants' accounts. There is no right to a particular form of investment, whether that investment is the result of a participant election or an employer allocation, although shares of employer securities diversified pursuant to sections 401(a)(28)(B) or 401(a)(35) elections cannot be mandatorily transferred back. Otherwise, any rebalancing or reshuffling provision must meet the benefits, rights, and features test of section 1.401(a)(4)-4 of the Regulations.

5) As previously stated, mandatory transfers of stock within a plan are permitted under the Code (see section 1.411(d)-4 of the Regulations), although the transfer must satisfy the nondiscrimination requirements of section 1.401(a)(4)-4 of the Regulations. As we stated above, reshuffling provisions that apply only to terminated employees and treat all of the terminated employees the same do not raise current or effective availability concerns, since under section 1.401(a)(4)-10 of the Regulations, terminated employees are tested separately from active employees. However, such reshuffling provisions must also comply with section 1.411(a)-11(c)(2)(i) of the Regulations, which provides that consent to a distribution is not valid if the plan imposes a significant detriment on a participant who does not consent to a distribution. In Revenue Ruling 96-47, terminated participants who did not elect a distribution lost the ability to choose from a range of investment options and were required to invest in a money market fund. The ruling concluded that the participants experienced a significant detriment under 1.411(a)-11(c)(2)(i). Accordingly, a plan providing participants with the option of an immediate distribution would need to have language that preserves sufficient investment options in order to ensure that the loss of the employer stock investment is not a "substantial detriment." For example, the plan might offer three alternative investment options such as described in Code section 401(a)(28)(B) or might offer other choices that include a life-cycle fund or targeted-retirement-date fund. Since ESOPs and stock bonus plans may provide for the option of an immediate distribution upon termination of employment, we believe that it is appropriate to request language providing for sufficient investment options. Please discuss with us should this become an issue.

Should you have any questions concerning this memorandum or any questions on related issues, please contact Robert Gertner at 202-283-9622 or Clare Diefenbach at 202-283-9614.