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The ESOP Association

June 30, 2009

Mr. Robert E. Gertner
Mr. Martin Pippins
Ms. Julie A. Heckler
Internal Revenue Service
Employee Plan Division
1111 Constitutional Ave., NW
Washington, DC 20224

Dear Mr. Gertner, Mr. Pippins & Ms. Heckler:

Enclosed is a Memorandum dated June 30, 2009, prepared by The ESOP Association's Advisory Committee on Legislative and Regulatory Issues. [L&R Committee of The ESOP Association]. The Memorandum is a requested response to topics and questions raised at a May 6, 2006, meeting between representatives of the L&R Committee of The ESOP Association and several representatives of the Internal Revenue Services Employee Plan Division, and the Department of Treasury's Benefits Council's Office of the Department's Office of Tax Policy.

The ESOP Association is a national 501(c)(6) entity whose primary members are corporate sponsors of employee stock ownership plans, or ESOPs. Also as members are men and women who provide a variety of services to ESOP sponsors such as legal, valuation, third party administration, financing, and similar services. The ESOP Association has approximately 2500 members nationwide, with members in all states.

The L&R Committee of The ESOP Association is a group of approximately 30 persons providing legal and similar services to ESOP sponsors, and whose role in The ESOP Association is to advise the volunteer Board of The ESOP Association on matters involving legislation and regulations. The current chair is Mr. Laurence A. Goldberg, Esq., Sheppard, Mullin, Richter & Hampton, 4 Embarcadero Center, Floor 17, San Francisco, California 94111-4158, telephone 415.774.2927, email lgoldberg@sheppardmullin.com.

The memorandum addresses very technical issues related to the appropriate actions by an ESOP sponsor to comply with all laws and regulations under the enforcement jurisdiction of the Department of Treasury and IRS with regard to tax qualified, deferred compensation plans. As needed, Mr. Goldberg and his colleagues included men and women from other Advisory Committees of The ESOP Association, such as the Administration Committee.

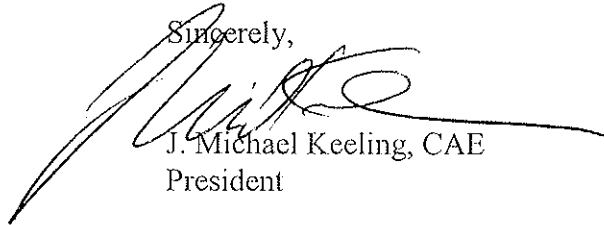
Serving The Entire ESOP Community

Internal Revenue Service
June 30, 2009
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Please contact the undersigned, or Mr. Goldberg, if you have inquiry about the attached/enclosed.

Finally, on behalf of The ESOP Association and its members, I express appreciation for the professionalism and openness of both the IRS personnel and Treasury personnel that work on enforcing the laws and regulations with regard to the creation and operation of employee ownership through the ESOP model.

Sincerely,

A handwritten signature in black ink, appearing to read "Mike Keeling", written over the typed name and title.

J. Michael Keeling, CAE
President

JMK:sgs

Enclosure

cc: Laurence A. Goldberg
Chair, The ESOP Association's
Advisory Committee on
Legislative and Regulatory Issues

MEMORANDUM

To: EP Determinations, Internal Revenue Service

**Martin Pippins
Robert Gertner
Julie Heckler**

From: Legislative & Regulatory Advisory Committee, The ESOP Association

Date: June 30, 2009

At our meeting in your offices on May 6, 2009, we discussed 12 issues that were listed in our memorandum to you dated April 16, 2009. You asked that we supply sample plan language for some of the points discussed. In addition, you asked us to assess the interest level in opening the volume submitter program to ESOPs. Our proposed sample plan language is included with this memorandum, along with a brief explanation of the language. The memo follows in the order of the April 16th memo. As before, please coordinate comments through Larry Goldberg.

Volume Submitter Program

At the beginning of our May 6th meeting, you suggested that opening the volume submitter program to ESOPs might be useful to practitioners and ESOP companies in resolving some of the matters that led to the production of the April 16th memo. In response, we informally polled the 35 or so members of the L & R Advisory Committee (including Associate members) and several of the members polled their contacts in the record keeping and consulting fields. Almost every professional responded by saying they either would not use the program or would not have enough clients that would use it to meet the 30 plan threshold.

It appears for the moment that practitioners would prefer to resolve the plan language differences through the current process rather than moving to the volume submitter program.

Items 3, 4, 5 and 11 – Incorporation by Reference of Exempt Loan Rules, Section 409(p) Preventive Provisions and Other Qualification Requirements

We have attached a Schedule showing several Code provisions that are appropriate for incorporation by reference along with our position on each.

Item 9 – Rebalancing and Reshuffling.

We have included sample plan language that provides for rebalancing accounts after the completion of regular allocations for each plan year.

Item 12 – Waiver of Plan Participation to Avoid Non-Allocation Year

We have included sample plan language allowing a participant (who has been participating in the ESOP) to waive participation in the ESOP for a plan year in order to avoid a non-allocation year. The sample plan language requires the waiver for the plan year to be irrevocable and communicated in writing to the plan administrator prior to the date the benefit accrues for such plan year.

Code Sections to be Incorporated by Reference into ESOP Document

It is not technically required, administratively feasible, or practically desirable to include in any plan document all of the provisions of the Internal Revenue Code of 1986 as amended (“Code”), regulations, and other guidance pertaining to the structure and operation of qualified retirement plans. Rather, plan documents should contain:

- terms specifically required to be in the plan document under the applicable provisions of the Code and regulations
- terms which are optional or elective, and thus must be documented in order to reflect the plan sponsor's selections
- terms which determine the basis on which the employer and employees will contribute to the plan, how benefits will accrue, when and in what form benefits will be distributed, etc.

Code Section	Reference	Reasoning
401(a)(9)	Minimum Required Distributions	It is a common drafting practice and a drafting practice expressly permitted by the Internal Revenue Service (“Service”) with respect to qualified plans which are not employee stock ownership plans (“ESOPs”) to use incorporation by reference in the drafting of plan documents. <i>See</i> Quality Assurance Bulletin 2004-5. However, Quality Assurance Bulletin 2004-5 is not applicable to ESOPs. Given the universal applicability of the provisions of Code section 401(a)(9), ESOPs, like all other qualified plans should be permitted to incorporate these provisions into their plan documents by reference.
410(a)(3) & 411(a)(5)	Hour of Service	It is a common drafting practice and a drafting practice expressly permitted by the Service with respect to qualified plans which are not ESOPs to use incorporation by reference in the drafting of plan documents. <i>See</i> Quality Assurance Bulletin 2004-5. However, Quality Assurance Bulletin 2004-5 is not applicable to ESOPs. Given the universal applicability of the provisions of Code section 410(a)(3) and 411(a)(5), ESOPs, like all other qualified plans should be permitted to incorporate these provisions into their plan documents by reference.
414(p)	QDROs	It is a common drafting practice and a drafting practice expressly permitted by the Service with respect to qualified plans which are not ESOPs to use incorporation by reference in the drafting of plan documents. <i>See</i> Quality Assurance Bulletin 2004-5. However, Quality Assurance Bulletin 2004-5 is not applicable to ESOPs. Given the universal applicability of the provisions of Code section 414(q), ESOPs, like all other qualified plans should be permitted to incorporate these provisions into their plan documents by reference.

414(u)	USERRA	It is a common drafting practice and a drafting practice expressly permitted by the Service with respect to qualified plans which are not ESOPs to use incorporation by reference in the drafting of plan documents. <i>See</i> Quality Assurance Bulletin 2004-5. However, Quality Assurance Bulletin 2004-5 is not applicable to ESOPs. Given the universal applicability of the provisions of Code section 414(u), ESOPs, like all other qualified plans should be permitted to incorporate these provisions into their plan documents by reference.
415	Annual Additions	It is a common drafting practice and a drafting practice expressly permitted by the Service with respect to qualified plans which are not ESOPs to use incorporation by reference in the drafting of plan documents. <i>See</i> Quality Assurance Bulletin 2004-5. However, Quality Assurance Bulletin 2004-5 is not applicable to ESOPs. Given the universal applicability of the provisions of Code section 415, ESOPs, like all other qualified plans should be permitted to incorporate these provisions into their plan documents by reference.
416	Top Heavy	It is a common drafting practice and a drafting practice expressly permitted by the Service with respect to qualified plans which are not ESOPs to use incorporation by reference in the drafting of plan documents. <i>See</i> Quality Assurance Bulletin 2004-5. However, Quality Assurance Bulletin 2004-5 is not applicable to ESOPs. Given the universal applicability of the provisions of Code section 416, ESOPs, like all other qualified plans should be permitted to incorporate these provisions into their plan documents by reference.
4975	Exempt Loan Rules	Treasury Regulation ("Treas. Reg.") Section 54.4975-11 establishes several requirements to be met by a plan in order to be an ESOP. For example, Treas. Reg. Section 54.4975-11(a)(3) states that the terms of an ESOP must "formally provide" (i) participants with certain protections and rights with respect to plan assets acquired with the proceeds of an exempt loan that are referred to in the third sentence of Section 54.4975-7(b)(4) and in Sections 54.4975-7(b)(10),(11), and (12) (the "Protections and Rights"), and (ii) that these Protections and Rights are nonterminable. The Protections and Rights relate to put, call, or other options and to buy-sell or similar arrangements. The Protections and Rights cannot, according to Treas. Reg. Section 54.4975-11(a)(3)(iii), merely be incorporated in the plan by reference to the applicable Treas. Reg. Sections; the Protections and Rights must be formally set forth in the plan. Treas. Reg. Section 54.4975-11 does not, however, provide that any other provisions in Section 54.4975-7(b) are required to be formally set forth in the plan. Since Treas. Reg. Section 54.4975-11 sets forth the requirements for a

		<p>plan to qualify as an ESOP, an inference can be made that if a provision is not incorporated in Treas. Reg. Section 54.4975-11 then the Department intended that the provision would not be a requirement for a plan to qualify as an ESOP.</p> <p>Furthermore, Treas. Reg. Section 54.4975-7(b) does not address the requirements for a plan to qualify as an ESOP but rather the requirements for a loan to be an "exempt loan." An "ESOP" is defined in Treas. Reg. Section 54.4975-7(b)(i) as "an employee stock ownership plan that meets the requirements of section 4975(e)(7) and section 54.4975-11." A plan does not need to meet the requirements of Treas. Reg. Section 54.4975-7(b) to qualify as an ESOP, except as provided in Section 54.4975-11, so incorporating by reference the provisions that are not required to be specifically set forth in a plan document should have no impact on whether the plan meets the qualifications of an ESOP. The provisions in Treas. Reg. Section 54.4975-7(b), however, should be included in the documentation for an exempt loan either specifically or through incorporation by reference to the Treas. Reg. Sections.</p> <p>For the reasons set forth above, we believe the following provisions may be incorporated by reference in the plan document:</p> <ul style="list-style-type: none">(a) Treas. Reg. Section 54.4975-7(b)(3), which provides that an exempt loan must be primarily for the benefit of the ESOP participants and their beneficiaries;(b) Treas. Reg. Section 54.4975-7(b)(4), which provides that an exempt loan must be used within a reasonable time after their receipt by the borrowing ESOP to acquire qualifying employer securities, to repay the exempt loan, or to repay a prior exempt loan;(c) Treas. Reg. Section 54.4975-7(b)(5), which provides that an exempt loan must be without recourse against the ESOP, only certain assets of the ESOP may be given as collateral for an exempt loan, and persons entitled to payment under an exempt loan share have rights to only certain assets of the ESOP.(d) Treas. Reg. Section 54.4975-7(b)(6), which provides that in the event of default upon an exempt loan, the value of plan assets transferred in satisfaction of the loan must not exceed the amount of default, and if the lender is a disqualified person, a
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		<p>loan must provide for a transfer of plan assets upon default only upon and to the extent of the failure of the plan to meet the payment schedule of the loan.</p> <p>(e) Treas. Reg. Section 54.4975-7(b)(7), which provides that the interest rate of a loan must not be in excess of a reasonable rate of interest.</p> <p>(f) Treas. Reg. Section 54.4975-7(b)(8), which provides that an exempt loan must provide for the release encumbrance of the plan assets used as collateral for the loan in accordance with the methods set forth in this section.</p> <p>(g) Treas. Reg. Section 54.4975-7(b)(9), which provides that qualifying employer securities acquired with proceeds of an exempt loan may, but need not, be subject to a right of first refusal. The requirements of a right of first refusal are as follows: (i) securities subject to the right must be stock or an equity security, or a debt security convertible into stock or an equity security; (ii) the securities must not be publicly traded at the time the right may be exercised; (iii) the right must be in favor of the employer, the ESOP, or both in any order of priority; (iv) the selling price and other terms under the right must not be less favorable to the seller than the greater of the value of the security determined under Treas. Reg. Section 54.4975-11(d)(5), or the purchase price and other terms offered by a buyer (other than an employer or the ESOP) making a good faith offer to purchase the security; and (v) the right must lapse no later than 14 days after the security holder gives written notice to the holder of the right that an offer by a third party to purchase the security has been received.</p> <p>(h) Treas. Reg. Section 54.4975-7(b)(13), which provides an exempt loan must be for a specific term.</p> <p>(i) Treas. Reg. Section 54.4975-7(b)(14), which provides that to be exempt a loan must be made to a plan that is an ESOP at the time of the loan or to a plan that is amended retroactively to comply with the Code to qualify as an ESOP if the plan was designated as an ESOP at the time of the loan but failed to be an ESOP because it did not comply with the Code.</p>
402	Eligible Rollover Rules	It is a common drafting practice to use incorporation by reference in many legal documents. While Quality Assurance Bulletin 2004-5 permits incorporation by reference for the applicable limits for elective deferrals under Section 402(g), it

		<p>does not permit similar incorporation for Eligible Rollover Distributions under Section 401(a)(31) to an Eligible Retirement Plan under Section 402(c)(8)(B) or the other rules applicable to rollovers from exempt trusts under Section 402 (collectively the "Rollover Rules"). Not permitting incorporation by reference for the Rollover Rules means that plan documents will need to be amended more frequently to reflect changes to the law. It does not appear to be feasible or desirable for the Service to create additional work in the form of amendments or more complicated plan documents which could be simplified through incorporation by reference. Aside from the policy reasons there are specific practical reasons that including detailed information in an applicable plan document may be duplicative. For example, participants receive a specific required notice explaining the Eligible Rollover Distributions set forth under Section 402(f). This notice has specific informational and timing requirements that will ensure that participants will be well informed concerning an Eligible Rollover Distribution including the tax implications. Based on these policy and practical reasons and the fact that the Rollover Rules can be cumbersome and overly detailed to administer in a plan document we believe the ability to incorporate them by reference into a form ESOP document should be permitted.</p>
1042	Non-Allocation Rules	<p>Section 4975(e)(7) of the Code states that a plan shall not be treated as an ESOP unless it meets certain requirements, including the requirements, if applicable, of Section 409(n) of the Code. The Application for Determination of ESOPs (Form 5309) also requests, in the case of a plan applying under Section 409(n) with respect to transactions under Section 1042, for the section and page number of the provision in the plan that provides that the assets of the plan attributable to employer securities acquired by the plan, in a sale to which Section 1042 applies, cannot accrue for the benefit of the persons specified in Section 409(n) during the non-allocation year. A plan document should contain the prohibited non-allocation language with respect to persons described in Section 409(n) if the plan is designed to permit the purchase of employer securities under Section 1042, but the plan document cannot and should not include all of the language contained in Section 409(n). The language contained in a plan document is intended to: (i) to set forth terms that are required by law to be included in the plan document; (ii) implement the "plan design" objectives of the plan sponsor; and (iii) provide guidance to the plan's administrator regarding the operation and administration of the ESOP. If the requirement of Section 409(n) is applicable to a plan, we believe the following language, which incorporates by</p>

		<p>reference persons specified in Section 409(n), should not disqualify a plan from being treated as an ESOP because the language includes the substantive requirements of Section 409(n) and provides the necessary guidance to the plan administrator:</p> <p>"No portion of the assets of the plan attributable to (or allocable in lieu of) employer securities acquired by the plan in a sale to which Code Section 1042 applies may accrue (or be allocated directly or indirectly under any plan maintained by the employer meeting the requirements of Code Section 401(a)) during the non-allocation period for the benefit of persons specified in Section 409(n)."</p>
409(p)	S Corp Discrimination Testing Definitions	<p>Code Section 409(p) requires that the plan provide that no portion of the assets of the plan attributable to (or allocable in lieu of) employer securities may, during a nonallocation year, accrue (or be allocated directly or indirectly under any plan of the employer meeting the requirements of section 401(a)) for the benefit of any disqualified person. Clearly, therefore, this language must appear in the plan document. See Code Section 409(p)(1). The Code, however, does not explicitly require recitation in the plan document of any other language within Section 409(p).</p> <p>The Treasury regulations under Section 409(p) require inclusion of plan language in only three respects:</p> <ul style="list-style-type: none"> • recital of the statutory prohibition as per Code Section 409(p)(1) -- Treas. Reg. Section 1.409(p)-1(b)(1) • prevention of a nonallocation year by transferring assets to a separate, non-ESOP portion of the plan -- Treas. Reg. Section 1.409(p)-1(b)(v) • use of fixed dates and triennial recalculations in determining the number of shares of synthetic equity -- Treas. Reg. Section 1.409(p)-1(f)(4)(iii)(B) and (C) <p>Neither the Code nor the regulations require that definitional language applicable to Section 409(p) be included in the plan document. While it is clear that the proper application of Code Section 409(p) does require the use of a number of specialized definitions which are presented in the Code, and restated and expanded upon in the regulations, e.g., "disqualified person," "prohibited allocation," "nonallocation year," "deemed -owned shares," and "synthetic equity," the question is whether, notwithstanding the absence of a statutory or regulatory mandate, there is some policy reason why these particular definitions must be restated in the plan document. We submit</p>

		<p>that there are no policy reasons supporting the inclusion of such additional language, and numerous reasons why such inclusion would be counter-productive. We believe it would be more conducive to good plan governance and the goal of achieving compliance with the statutory and regulatory requirements to allow the plan document to incorporate by reference the relevant definitional provisions:</p> <ul style="list-style-type: none"> • It does not seem to be the Service's intent that plan fiduciaries administer Section 409(p) compliance solely by reference to the plan documents -- recourse must be had in any event to the Code, regulations and other applicable guidance -- so inclusion of the statutory and regulatory definitions adds nothing in terms of ease or efficiency of plan administration • Attempts to summarize the relevant definitions, so as to avoid restating the entire body of regulations in the plan document, will inevitably lead to omissions and misinterpretations of the applicable rules, and make it much less likely that plan fiduciaries and their advisors will look to the Code and regulations as the primary source of guidance • Rank-and-file plan participants will not be relying on Section 409(p) definitions in the plan document in order to determine their benefit entitlements under the plan • Requiring that the plan document reflect not only the Code and regulations, but also "applicable guidance," means that the plan document will need to be frequently amended to reflect changes in the regulations as well as the issuance of revenue rulings and other IRS pronouncements <p>Inclusion in the plan document of the basic prohibitory language of Section 409(p), as required by Section 409(p)(1), coupled with incorporation by reference of the relevant statutory and regulatory definitions, increases the likelihood that employers, plan fiduciaries and their advisors will appropriately observe the applicable rules, and reduces the likelihood that over-reliance on the "four corners" of the plan document will lead to unintentional violations of Section 409(p).</p>
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Sample Plan Language – Rebalancing and Reshuffling

"a) Rebalancing of Accounts - As of January 1, 2009, and as of each December 31st thereafter after the completion of the allocation of Employer Contributions, Forfeitures and net income (loss) of the Trust for each Plan Year, the balances of each Participant's Company Stock Account and Other Investments Account shall be adjusted through rebalancing as provided in this Section ____ (a). The number of shares of Company Stock in a Participant's Company Stock Account following rebalancing shall be determined by multiplying the total number of shares of Company Stock in the Trust by the percentage that his Account balances represents of the total Account balances of all such Participants. The balance of a Participant's Other Investments Account following rebalancing shall be determined by multiplying the total Other Investment Account balances of all Participants by the percentage that his Account balances represents of the total Account balances of all Participants.

To the extent that the Accounts of terminated Participants are diversified and invested in assets other than Company Stock (as provided in Section 12(d)), such Accounts shall not be included in the rebalancing of Accounts and shall remain invested in assets other than Company Stock. To the extent that the Accounts of Participants are subject to the limitations described in Code Section 409(n) and Code Section 409(p), such Accounts shall not included in the rebalancing of Accounts."

Sample Plan Language – Waiver of Plan Participation to Avoid Non-Allocation Year

"Voluntary Waiver of Participation by Disqualified Persons.

In order to prevent a Non-allocation Year or a prohibited allocation during a Non-allocation Year, a Disqualified Person (or a Plan participant reasonably expected to become a Disqualified Person absent the limitation described herein), shall be permitted (as provided herein) to make a voluntary irrevocable election to waive his or her participation in any allocation for such Plan Year for which, absent such Participant's waiver, would result in a Non-allocation Year. The Participant's waiver shall be solely at the election of the Participant, and must be delivered to the Plan Administrator in writing prior to the date on which the allocation for such Plan Year has accrued pursuant to the terms of the Plan."