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**Re: Troubling New ESOP Regulations Will Cause Problems for U.S. Subs of Foreign Companies**

Dear Clients and Other Friends:

We sometimes work with non-U.S. companies whose U.S. subsidiaries sponsor Employee Stock Ownership Plans. Typically, such a company would conduct its U.S. operations through a subsidiary incorporated in the United States, and the subsidiary would sponsor an ESOP funded with American Depositary Shares of the parent company.

Regulations proposed by the IRS last week will have a **significant adverse impact** on such companies.

That is, the regulations provide that the deduction available under U.S. tax law for dividends paid on the stock held by the ESOP can only be taken by the parent company, not by the U.S. subsidiary. If the parent company's U.S. operations are conducted entirely by the subsidiary and not at all by the parent, and the parent does not have any U.S. taxable income, then neither the parent nor the U.S. subsidiary will receive any tax benefit from the dividend deduction. For large multi-national companies, the deduction can be a multi-million dollar amount, so this proposed regulation is a big deal.

It should be emphasized that the regulations are proposed, not final, and conceivably concerned taxpayers will be able to make the case that these regulations should be modified or withdrawn. In any event, companies that will be affected by these new rules should consider how to respond.

In addition, the regulations follow up on other pronouncements in which the IRS has taken the position that amounts an employer pays to reacquire employer stock from an ESOP in connection with benefit payments to terminating employees are not deductible by the employer as dividends. This part of the regulation emphasizes that the IRS continues to disagree with the 9<sup>th</sup> Circuit Court of Appeals 2003 Boise Cascade decision.

If you would like our help in responding to the IRS about these regulations, let us know.

Sincerely,

A. David Kelly

ADK/jks