

Part III –Administrative, Procedural and Miscellaneous

Definition of Readily Tradable On An Established Securities Market

Notice 2011-19

Purpose

This notice provides guidance regarding when securities of the employer are *readily tradable on an established securities market* or *readily tradable on an established market* for purposes of certain provisions of the Internal Revenue Code relating to employer securities held by certain qualified retirement plans.

Background

Section 4975(e)(7) defines an employee stock ownership plan (ESOP) as a defined contribution plan (1) which is a stock bonus plan which is qualified under § 401(a), or a stock bonus and a money purchase plan both of which are qualified under § 401(a), and which are designed to invest primarily in qualifying employer securities as defined in §4975(e)(8), and (2) which is otherwise defined in regulations prescribed by the Secretary. Section 4975(e)(7) also states that an employee stock ownership plan must satisfy certain requirements in §409, including the requirements of § 409(h). In addition, §401(a)(23) generally provides that a stock bonus plan is not a qualified plan under §401(a) unless the plan meets certain requirements, including the requirements of §409(h).

Section 401(a)(22) generally provides that a defined contribution plan (other than a profit sharing plan) must meet the requirements of §409(e) (which relates to passthrough of voting rights) if it is established by an employer whose stock is not *readily tradable on an established market*, and after acquiring

securities of the employer, more than 10 percent of the total assets of the plan are securities of the employer.

Section 409(h) provides generally that a plan satisfies the requirements of §409(h) if the plan offers a participant who is entitled to a distribution the right to demand payment in the form of employer securities and, if the employer securities are not *readily tradable on an established market*, the participant must also have the right to require that the employer repurchase the employer securities under a fair valuation formula (put option).

Section 401(a)(35)(A) provides that a trust which is part of an applicable defined contribution plan is not a qualified trust under §401(a) unless the plan satisfies certain diversification requirements set forth in §401(a)(35)(B), (C), and (D). Subject to certain exceptions, an applicable defined contribution plan under §401(a)(35) is a defined contribution plan that holds any publicly traded employer securities. A publicly traded employer security is defined in §401(a)(35)(G)(v) as an employer security under section 407(d)(1) of ERISA which is *readily tradable on an established securities market*.

Section 401(a)(28) provides that an ESOP, and a tax credit employee stock ownership plan under §409(a), is not a qualified plan under §401(a) unless the plan meets the requirements of §401(a)(28)(B) and (C). Section 401(a)(28)(B) imposes certain diversification requirements with respect to certain participants. Section 401(a)(28)(B) was amended by the Pension Protection Act of 2006, Pub. L. 109-280, 120 Stat. 780 (PPA '06) to not apply to a plan to which §401(a)(35) applies. For employer securities that are not *readily tradable on an*

established securities market, §401(a)(28)(C) requires all valuations with respect to activities carried on by the plan to be made by an independent appraiser that meets requirements similar to the requirements of regulations under §170(a)(1).

Section 404(k) generally permits an income tax deduction for the amount of any applicable dividend paid in cash by a C corporation with respect to applicable employer securities. For this purpose, applicable employer securities are generally defined to mean employer securities as defined in §409(l) held by an ESOP.

Section 4975(e)(8), as amended by the Technical Corrections Act of 1979, P.L. 96-22 (1980), provides that qualifying employer securities must meet the definition set forth in §409(l). Section 409(l)(1) defines employer securities as common stock issued by the employer (or by a corporation that is a member of the same controlled group) which is *readily tradable on an established securities market* and provides special rules for an employer that has no class of stock which is *readily tradable on an established securities market*. In the absence of any guidance of general applicability, some plans may have applied the definition of “publicly traded” at §54.4975-7(b)(1)(iv) of the Excise Tax Regulations (issued before enactment of the Technical Corrections Act of 1979) to determine whether employer securities are readily tradable on an established securities market within the meaning of §409(l)(1).

Section 1042 generally provides that, if the taxpayer or executor so elects, gain on the sale of qualified employer securities which would be recognized as long-term capital gain is recognized only to the extent the gain exceeds the cost

of qualified replacement property acquired within the replacement period. This treatment applies only if the sale is to an ESOP or eligible worker-owned cooperative that holds at least 30 percent of the corporation's stock after the sale, and various other conditions in §1042(b) are satisfied. In addition, under §1042(c), the only securities eligible for this treatment are employer securities defined under §409(l) and issued by a domestic C corporation that has no stock outstanding that is *readily tradable on an established securities market*.

Final regulations under §401(a)(35) were issued on May 18, 2010 (75 FR 27927). Under §1.401(a)(35)-1(f)(5), a security is *readily tradable on an established securities market* if the security is traded on a national securities exchange that is registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f). The regulations also treat a security as *readily tradable on an established securities market* if the security is traded on a foreign national securities exchange that is officially recognized, sanctioned, or supervised by a governmental authority and where the security is deemed by the Securities and Exchange Commission (SEC) as having a ready market under SEC Rule 15c3-1 (17 CFR 240.15c3-1). Under the current SEC rules, a security that is included on the FTSE Group (FTSE) All-World Index is deemed to have a ready market. Section 1.401(a)(35)-1 is effective for plan years beginning on or after January 1, 2011.

Readily tradable on an established securities market or established market

Under this notice, the terms *readily tradable on an established securities market* and *readily tradable on an established market*, with respect to employer

securities, each mean employer securities that are readily tradable on an established securities market within the meaning of §1.401(a)(35)-1(f)(5) for purposes of the following provisions: (1) §401(a)(22); (2) §401(a)(28)(C); (3) §409(h)(1)(B); (4) §409(l); and (5) § 1042(c)(1)(A).

Effective Date

This notice is effective for plan years beginning on or after January 1, 2012. However, this notice is not effective until plan years beginning on or after January 1, 2013 for any plan that is sponsored by an employer with respect to which, on March 14, 2011, neither the employer nor any member of its controlled group (within the meaning of § 409(l)) has any common stock that is readily tradable on an established securities market within the meaning of §1.401(a)(35)-1(f)(5)(A) (relating to securities that are traded on a national securities exchange that is registered under section 6 of the Securities Exchange Act of 1934), but the employer or a member of its controlled group has common stock that is readily tradable on an established securities market within the meaning of §1.401(a)(35)-1(f)(5)(B) (relating to securities that are traded on a foreign national securities exchange that is officially recognized, sanctioned, or supervised by a governmental authority and is deemed by the SEC as having a “ready market” under SEC Rule 15c3-1, within the meaning of §1.401(a)(35)-1(f)(5)(B)). Taxpayers (including any employer sponsoring a plan described in the preceding sentence) can rely on this notice for periods after March 14, 2011.

Drafting Information:

The principal author of this notice is Robert Gertner of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans taxpayer assistance answering service at 1-877-829-5500 (a toll-free number) or e-mail Mr. Gertner at RetirementPlanQuestions@irs.gov.