

IRS Clarifies Meaning of 'Publicly Traded' for ESOPs

3/3/2011

[Vernon P. Saper](#), [Justin W. Stemple](#)

The operation of an ESOP can be significantly affected by whether or not the employer stock in the ESOP is publicly traded. The IRS has recently issued guidance clarifying what standards determine if employer stock is "publicly traded" -- the IRS uses the terms "readily tradable on an established securities market" or "readily tradable on an established market."

Many key provisions of an ESOP are affected by whether or not employer stock is publicly traded. These include:

- Pass through of voting rights
- Put option upon distribution of employer stock
- Diversification rights
- Independent appraisal requirements
- Qualifying employer securities
- 042 rollover

In 2010, the IRS issued regulations that defined "publicly traded" under Section 401(a)(35) of the Internal Revenue Code. Under that regulation, employer stock is publicly traded if it is traded on either:

- A national securities exchange that is registered under Section 6 of the Securities Exchange Act of 1934 (e.g., NYSE or NASDAQ), or
- 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 as having a ready market (e.g., the FTSE Group All-World Index).

On March 1, 2011, the IRS issued guidance that the regulatory definition of publicly traded for purposes of Section 401(a)(35) applies to the ESOP provisions listed above. Only employer stock that satisfies the regulatory definition is considered publicly traded for ESOP purposes. ESOPs holding any other employer stock must satisfy the ESOP requirements that apply to non-publicly traded companies, even if the employer stock is traded on the over-the-counter bulletin board or otherwise.

If you would like to learn more about ESOPs, please contact Vern Saper (vsaper@wnj.com or 616.752.2116) or Justin Stemple (jstemple@wnj.com or 616.752.2375). Also, if you know others within or outside your organization who might benefit from reading this newsletter, please send their contact information to vsaper@wnj.com and we will add them to our mailing list.