Pension Analyst
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Guidance provided on “readily tradable” employer securities

Recently, the IRS issued Notice 2011-19 to provide guidance describing when employer securities are “readily tradable on an established securities market” or “readily tradable on an established market” for purposes of the Internal Revenue Code (the Code). This guidance affects qualified defined contribution plans that hold employer stock, including Employee Stock Ownership Plans (ESOPs).

Background

Effective for plan years beginning on or after January 1, 2007, any defined contribution plan that offers publicly-traded employer stock as an investment option must provide diversification rights for amounts invested in employer stock. For purposes of this diversification requirement, IRS regulations provide that employer stock is “publicly-traded” if it is readily tradable on an established stock market. A stock is “readily tradable on an established stock market” if it is traded on a:

- Securities exchange registered under the Securities and Exchange Act (such as the New York Stock Exchange or NASDAQ); or
- Foreign national securities exchange that is officially recognized, sanctioned or supervised by a governmental authority and the Securities and Exchange Commission (SEC) deems the stock as having a ready market.

Other provisions of the Code refer to securities that are “readily tradable” on either “an established market” or “an established securities market,” but do not define these terms. These provisions include:

- The requirement that a defined contribution plan, (other than a profit sharing plan) provide pass-through voting rights if the employer stock held by the plan is not readily tradable on an established market, and more than 10% of the total plan assets of the plan are employer securities.
- The requirement that ESOP participants who have the right to receive payment in the form of employer securities, also have the right to “put” the securities to the employer for repurchase under a fair valuation formula if the employer securities are not readily tradable on an established market.
- The requirement that an ESOP or a stock ownership plan that holds employer securities which are not readily tradable on an established securities market are valued by an independent appraiser.
- The definition of employer securities, for ESOP purposes, as common stock issued by the employer that is readily tradable on an established market.
- The provision allowing a taxpayer that sells employer securities that are readily tradable on an established securities market to an ESOP to defer the gain if the proceeds are used to purchase qualified replacement property.

Notice 2011-19

The IRS has now clarified that the terms *“readily tradable on an established securities market”* and *“readily tradable on an established market”* have the same meaning as provided in the diversification regulations described above.

Effective date

This guidance is generally effective for plan years beginning on or after January 1, 2012. However, a delayed effective date applies if on March 14, 2011, neither the employer nor any member of its controlled group had any common stock that was readily tradable on a domestic exchange, but has common stock that is deemed by the SEC to be readily tradable on a foreign exchange. In this situation, the guidance is effective for plan years beginning on or after January 1, 2013. Plan sponsors may rely on this guidance for periods after March 14, 2011.

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