

[4830-01-p]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

REG-129709-03

RIN 1545-BC34

Prohibited Allocations of Securities in an S Corporation

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing.

SUMMARY: In the Rules and Regulations section of this issue of the **Federal Register**, the IRS is issuing temporary regulations that provide guidance on the definition and effects of a prohibited allocation under section 409(p), identification of disqualified persons and determination of a nonallocation year, calculation of synthetic equity under section 409(p)(5), and standards for determining whether a transaction is an avoidance or evasion of section 409(p). These proposed regulations would generally affect plan sponsors of, and participants in, ESOPs holding stock of Subchapter S corporations. The text of those temporary regulations also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by March 17, 2005.

Requests to speak (with outlines of oral comments to be discussed) at the public

hearing scheduled for April 20, 2005, at 10 a.m. must be received by March 30, 2005.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG-129709-03), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-129709-03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the IRS Internet site at [www.irs.gov/regs](http://www.irs.gov/regs) or the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS-REG-129703-03).

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulations, John Ricotta at 622-6060; concerning submissions of comments, requests to speak at the hearing or to be placed on the building access list to attend the hearing, contact Guy Traynor at 202-622-3693 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:**

**Background**

Temporary regulations in the Rules and Regulations portion of this issue of the **Federal Register** amend the Income Tax Regulations (26 CFR part 1) relating to section 409(p). The temporary regulations contain rules relating to the definition and effects of a prohibited allocation under section 409(p), identification of disqualified persons and determination of a nonallocation year, calculation of synthetic equity under section 409(p)(5), and standards for determining whether a transaction is an avoidance or evasion of section 409(p). The text of those

temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations.

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Because §1.409(p)-1 imposes no new collection of information on small entities, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### **Comments and Requests for a Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and 8 copies) or electronic comments that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for April 20, 2005, at 10 a.m. in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC. All visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts at the

Constitution Avenue entrance. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by March 30, 2005. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

### **Drafting Information**

The principal author of these regulations is John Ricotta of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury participated in their development.

### **List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

### **Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

#### **PART 1--INCOME TAXES**

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read, in part, as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Section 1.409(p)-1 also issued under 26 U.S.C. 409(p)(7)(A). \* \* \*

Par. 2. Section 1.409(p)-1 is added to read as follows:

§1.409(p)-1 Prohibited allocation of securities in an S corporation.

[The text of proposed §1.409(p)-1 is the same as the text of §1.409(p)-1T published elsewhere in this issue of the **Federal Register**].

Mark E. Matthews,  
Deputy Commissioner for Services and Enforcement.