

deemed-owned ESOP and synthetic equity shares of the S corporation;

(iii) The aggregate number of deemed-owned ESOP shares of such person and of the members of such person's family is at least 20 percent of the number of deemed-owned ESOP shares of the S corporation; or

(iv) The aggregate number of deemed-owned ESOP shares and synthetic equity shares of such person and of the members of such person's family is at least 20 percent of the aggregate number of deemed-owned ESOP and synthetic equity shares of the S corporation.

(2) *Treatment of family members; definition.* (i) Each member of the family of any person who is a disqualified person under paragraph (d)(1)(iii) or (iv) of this section is a disqualified person. *Member of the family* means, with respect to an individual—

(A) The spouse of the individual;

(B) An ancestor or lineal descendant of the individual or the individual's spouse;

(C) A brother or sister of the individual or of the individual's spouse and any lineal descendant of the brother or sister; and

(D) The spouse of any individual described in paragraph (d)(2)(ii) or (iii) of this section.

(ii) A spouse of an individual who is legally separated from such individual under a decree of divorce or separate maintenance is not treated as such individual's spouse for purposes of this paragraph (d)(2).

(3) *Special rule for certain nonallocation years.* See paragraph (c)(3) of this section (relating to avoidance or evasion of section 409(p)) for a special rule permitting any person to be treated as a disqualified person in certain nonallocation years.

(e) *Deemed-owned ESOP shares.* A person is treated as owning his or her deemed-owned ESOP shares. *Deemed-owned ESOP shares* mean, with respect to any person—

(1) Any shares of stock in the S corporation constituting employer securities that are allocated to such person's account under the ESOP; and

(2) Such person's share of the stock in the S corporation that is held by the ESOP but is not allocated to the account of any participant or beneficiary (with such person's share to be determined in the same proportion as the most recent stock allocation under the ESOP).

(f) *Synthetic equity*—(1) *Ownership of synthetic equity.* For purposes of section 409(p) and this section, synthetic equity is treated as owned by a person in the same manner as stock is treated as owned by a person, directly or under the rules of section 318(a)(2) and (3).

*Synthetic equity* means the rights described in paragraph (f)(2) of this section.

(2) *Synthetic equity*—(i) *Rights to acquire stock of the S corporation.* *Synthetic equity* includes any stock option, warrant, restricted stock, deferred issuance stock right, stock appreciation right payable in stock, or similar interest or right that gives the holder the right to acquire or receive stock of the S corporation in the future. Rights to acquire stock in an S corporation with respect to stock that is, at all times during the period when such rights are effective, both issued and outstanding and held by persons other than the ESOP, the S corporation, or a related entity, are not synthetic equity (but see paragraph (c)(4) of this section).

(ii) *Special rule for certain stock rights.* *Synthetic equity* also includes a right to a future payment (payable in cash or any other form other than stock of the S corporation) from an S corporation that is based on the value of the stock of the S corporation or appreciation in such value, such as a stock appreciation right with respect to stock of an S corporation that is payable in cash or a phantom stock unit with respect to stock of an S corporation that is payable in cash.

(iii) *Rights to acquire assets of an S corporation or related entity*—(A) *Rights to acquire interests in a related entity*—(1) *Treatment as synthetic equity.* *Synthetic equity* includes a right to acquire stock or other similar interests in a related entity that is described in this paragraph (f)(2)(iii)(A).

(2) *Significant interests.* *Synthetic equity* includes a right to acquire stock or other similar interests in a related entity if such interests in the related entity are the only significant asset of the S corporation and the S corporation is the only significant owner of the related entity. Whether an asset is the only significant asset of the S corporation or the S corporation is the only significant owner of the related entity depends on the relevant facts and circumstances.

(3) *Rights to acquire interests in other related entities.* [Reserved]

(4) *Related entity.* For purposes of this section, *related entity* means any entity in which the S corporation holds an interest and which is a partnership, a trust, an eligible entity that is disregarded as an entity that is separate from its owner under § 301.7701-3 of this chapter or a Qualified Subchapter S Subsidiary under section 1361(b)(3).

(B) *Rights to acquire assets of an S corporation or related entity other than rights to acquire stock or similar*

*interests in a related entity*—(1) *General rule.* [Reserved]

(2) *Exception for rights to acquire goods or services in ordinary course of business.* *Synthetic equity* does not include rights to acquire goods or services at fair market value in the ordinary course of business.

(C) *Authority to provide guidance.* The Commissioner, in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(B) of this chapter), may provide that *synthetic equity* includes a right to acquire stock or other similar interests in a related entity in cases in which such interests in the related entity are not the only significant asset of the S corporation or the S corporation is not the only significant owner of the related entity if necessary to carry out the purposes of section 409(p).

(D) *Synthetic equity includes comparable rights.* An option or right to acquire assets of the S corporation or another person is treated as synthetic equity if such option or right is part of a structure that provides rights to the holder comparable to the rights provided by arrangements identified as synthetic equity under this paragraph (f)(2)(iii) and the principal purpose of the structure is the avoidance or evasion of section 409(p).

(iv) *Special rule for nonqualified deferred compensation.* *Synthetic equity* also includes any remuneration for services rendered to the S corporation, or a related entity, to which section 404(a)(5) applies (including remuneration for which a deduction would be permitted under section 404(a)(5) if separate accounts were maintained), any right to receive property (to which section 83 applies) in a future year for the performance of services to an S corporation, or related entity, and any transfer of property (to which section 83 applies) in connection with the performance of services to an S corporation, or a related entity, to the extent that the property is not substantially vested within the meaning of § 1.83-3(i) by the end of the plan year in which transferred. *Synthetic equity* also includes any other remuneration for services rendered to the S corporation, or a related entity, under a plan, or method or arrangement, deferring the receipt of compensation to a date that is after the 15th day of the 3rd calendar month after the end of the entity's taxable year in which the related services are rendered, other than a plan that is an eligible retirement plan within the meaning of section 402(c)(7)(B).