

(3) *No overlap among shares of deemed-owned ESOP shares or synthetic equity.* Synthetic equity under this paragraph (f) does not include shares that are deemed-owned ESOP shares. In addition, synthetic equity under a specific subparagraph of this paragraph (f) does not include anything that is synthetic equity under a preceding subparagraph of this paragraph (f).

(4) *Number of synthetic shares—(i) Synthetic equity determined by reference to S corporation shares.* In the case of synthetic equity that is determined by reference to shares of stock of the S corporation, the person who is entitled to the synthetic equity is treated as owning the corresponding number of shares of stock. For example, if a corporation grants an employee of an S corporation an option to purchase 100 shares of the corporation's stock, the employee is the deemed owner of 100 synthetic equity shares of the stock of the corporation.

(ii) *Synthetic equity determined by reference to shares in a related entity.* In

the case of synthetic equity that is determined by reference to shares of stock (or similar interests) in a related entity, the person who is entitled to the synthetic equity is treated as owning shares of stock of the S corporation with the same aggregate value as the number of shares of stock (or similar interests) of the related entity (with such value determined without regard to any lapse restriction as defined at § 1.83–3(i)).

(iii) *Other synthetic equity.* In the case of any other synthetic equity, the person who is entitled to the synthetic equity is treated as owning a number of shares of stock in the S corporation equal to the present value of the synthetic equity (with such value determined without regard to any lapse restriction as defined at § 1.83–3(i)) divided by the fair market value of a share of the S corporation's stock as of the same date. For purposes of this paragraph (f)(4)(iii), the number of shares of S corporation is permitted to be determined as of the first day of the ESOP's plan year, or any other reasonable determination date or dates during a plan year that is consistently

used by the corporation for this purpose for all persons. The number of shares of synthetic equity treated as owned for any period from a determination date through the date immediately preceding the next following determination date is the number of shares treated as owned on the first day of that period.

(g) *Examples.* The rules of this section are illustrated by the following examples:

Example 1. (i) Facts. Corporation X is a calendar year S corporation that maintains an ESOP. X has a single class of common stock, of which there are a total of 1,200 shares outstanding. X has no synthetic equity. In 2006, individual A, who is not an employee of X (and is not related to any employee of X), owns 100 shares directly, individual B owns 100 shares directly, and the remaining 1,000 shares are owned by an ESOP maintained by X for its employees. The ESOP's 1,000 shares are allocated to the accounts of individuals who are employees of X (none of whom are related), as set forth in columns 1 and 2 in the following table:

1—Shareholders	2—Deemed-owned ESOP shares (total of 1,000)	3—Percentage deemed-owned ESOP shares	4—Disqualified person
B	33	33	Yes.
C	145	14.5	Yes.
D	75	7.5	No.
E	30	3	No.
F	20	2	No.
Other participants	400 (none exceed 10 shares)	1 or less	No

(ii) *Conclusion with respect to disqualified persons.* As shown in column 4 in the table above, individuals B and C are disqualified persons for 2006 under paragraph (d)(1) of this section because each owns at least 10% of X's deemed-owned ESOP shares.

(iii) *Conclusion with respect to nonallocation year.* However, 2006 is not a

nonallocation year under section 409(p) because disqualified persons do not own at least 50% of X's outstanding shares (the 100 shares owned directly by B, B's 330 deemed-owned ESOP shares, plus C's 145 deemed-owned directly by B, B's 330 deemed owned ESOP shares, plus C's 145 deemed-owned

ESOP shares equal only 47.9% of the 1,200 outstanding shares of X).

Example 2. (1) Facts. The facts are the same as in *Example 1*, except that, as shown in column 4 of the table below, individual E has an option to acquire 500 shares of the common stock of X from X:

1—Shareholders	2—Deemed-Owned ESOP shares (total of 1,000)	3—Percentage deemed-owned ESOP shares	4—Synthetic equity (500)	5—Percentage deemed-owned ESOP plus Synthetic equity shares (total of 1,500)	6—Disqualified person
B	330	33 .....	.....	22	Yes (cols. 3 and 5).
C	145	14.5 .....	.....	9.7	Yes (col. 3).
D	75	7.5 .....	.....	5	No.
E	30	3	500	35.3	Yes (col. 5).
F	20	2 .....	.....	1.3	No.
Other participants	400 (none exceed 10 shares).	1 or less .....	.....	under 1	No.

(ii) *Conclusion with respect to disqualified persons.* E's option constitutes 500 shares of synthetic equity. Accordingly, as shown in column 6 in the table above, individuals B, C, and E are disqualified persons for 2006 because each owns at least 10% of X's deemed-owned ESOP shares or X's total

deemed-owned ESOP and synthetic equity shares.

(iii) *Conclusion with respect to nonallocation year.* The 100 shares owned directly by B, B's 330 deemed-owned ESOP shares, C's 145 deemed-owned ESOP shares, E's 30 deemed-owned ESOP shares, plus E's

500 synthetic equity shares equals 65% of the 1,700 outstanding and synthetic equity shares of X. Thus, 2006 is a nonallocation year for X's ESOP under section 409(p) because disqualified persons own at least 50% of X's total shares of outstanding stock and synthetic equity. In addition,