

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200423018**

Release Date: 6/4/04

Index Number: 1042.02-03

Person To Contact:

Telephone Number:

In Re:

Refer Reply To:

CC:TEGE:EB:QP2 – PLR-159257-03

Date:

February 18, 2004

LEGEND

Taxpayers =

Company =

ESOP =

X Shares =

State Y =

Investment Firm =

Investment Advisor =

Tax Accountant =

Dear :

This responds to your letter on behalf of the above-named taxpayers requesting a ruling, under the facts described below, that the taxpayers will be treated as having substantially complied with the requirements of section 1.1042-1T of the Temporary Income Tax Regulations concerning notarized statements of purchase in connection

with the sale of stock of the Company to the employee stock ownership plan (ESOP) maintained by the Company.

Taxpayer A owned X shares of Company common stock. The stock was acquired by Taxpayer A by inheritance. Taxpayer A had not received the stock in a distribution from a plan described in section 401(a), or in a transfer pursuant to an option, or other right to acquire stock to which sections 83, 422, 422A, 423 or 424 of the Internal Revenue Code of 1986 (Code) applied.

The Company is a domestic C corporation that has never had any stock outstanding on an established securities market. We will assume for purposes of this ruling request that common stock of the Company constitutes qualified securities within the meaning of section 1042(c)(1) of the Code and that the ESOP is qualified under section 401(a) and meets the requirements of section 4975(e)(7).

On September 18, , Taxpayer sold X shares of common stock of the Company to the ESOP. As a result of the sale, Taxpayer realized a gain. After this transaction, and related contemporaneous transactions involving other shareholders of the Company, the ESOP held more than 30 percent of the total value of all outstanding stock of the Company (other than stock described in section 1504(a)(4)).

During May and June of , Taxpayers were on an extended motor-home trip to the U.S. east coast and mid-west regions, and were not planning to return to their home in State Y until the first week of July . Taxpayer first heard about the offer to purchase the Company's shares, and the short time frame for responding to the offer, through a telephone call from a relative who also owned shares in the Company. Taxpayer flew home to obtain the stock certificate from Taxpayer's safe deposit box and to retrieve the mail, copies of a memorandum dated June 4, , from management of the Company, the formal offer to purchase (dated June 13,) from the ESOP administrator and trustee and the letter of transmittal to tender Taxpayer's common stock.

After Taxpayer's return from the Midwest in June , Taxpayer spoke with the ESOP administrator and trustee, as well as the attorney for the Company, about certain details of the transaction and then signed and submitted Taxpayer's notarized letter of transmittal and stock certificate. These individuals did not advise the Taxpayer of the 30 day notarization requirement applicable to statements of purchase of qualified replacement property contained in section 1.1042-1T of the Temporary Income Tax Regulations.

After Taxpayer's return to State Y in July , Taxpayer met with Taxpayer's investment advisor to inform her that the Taxpayer would soon be receiving a large payment and to discuss the best method for reinvesting the proceeds. Taxpayer informed the investment advisor of the 15 month replacement period and of the

requirement to invest the proceeds in qualified replacement property. The investment advisor indicated that she was not familiar with these requirements but would consult the home office to make certain that only appropriate investments were purchased. Neither the home office nor the investment advisor advised Taxpayer of the 30 day notarization requirement.

On September 26, _____, Taxpayer received a letter from the trustee bank transmitting a check in the amount of the sales price and suggesting that the Taxpayer consult a tax professional concerning the tax consequences of the sale.

While documents received by the Taxpayer contained suggestions to obtain tax advice, Taxpayers assumed they had been told all the significant requirements and assumed the investment firm would have informed them if there were any further requirements relating to the stock purchases. Taxpayers also believed that their tax accountant would know how to properly report the transaction on Taxpayers' returns. Accordingly, Taxpayers did not consult with a tax accountant.

On September 26, _____, the sales proceeds were deposited in a new separate Investment Firm account designated as the Taxpayers' ESOP account.

During the period October 3, _____, through February 28, _____, Taxpayers purchased qualified replacement property with monies from the Taxpayers' ESOP account. Since both Taxpayers and the investment advisor were unaware of the 30 day notarization requirement, no notarized statements of purchase were prepared within 30 days of each purchase.

In March of _____, Taxpayers received a memorandum dated March 11, _____, from the attorney for the Company containing more specific information about the tax filing requirements and, for the first time, mentioning the 30 day notarization requirement.

On March 14, _____, Taxpayers delivered their _____ tax return information, including documents relating to the sale to the ESOP, to Tax Accountant. During the tax return preparation process, Tax Accountant's associate reviewed the documents relating to the sale to the ESOP and recommended meeting with taxpayers to discuss the requirements of section 1042 and the regulations. This meeting took place on April 11, 2003. Tax Accountant's associate advised taxpayers to file an extension of time to file their _____ returns.

On April 17, _____, Tax Accountant's associate met with taxpayers and investment advisor to review facts and make certain that all purchases of replacement property made after March 18, _____, were properly notarized.

On August 6, , taxpayers executed and had notarized the Statement of Election to treat the sale of shares of Company stock to the ESOP as a 1042 sale. On the same day, taxpayers had statements of purchase for qualified replacement property purchased between October 3, and February 28, notarized. Statements of purchase for qualified replacement property purchased from March 25 to March 28, , and from June 27 to July 2, , were notarized within 30 days of purchase.

On August 15, Tax Accountant filed a request for an additional extension of time until October 15, , for filing taxpayers' income tax return. On or before October 15, Taxpayers filed their income tax return and included a statement electing nonrecognition treatment under section 1042, as well as a statement of consent pursuant to section 1042(b) signed by the Company whereby the Company agreed to be bound by the terms of sections 4978 and 4979A. The notarized statements of purchase as described above were filed with the Taxpayers' income tax return.

You have requested a ruling that, based on the specific facts of this case, the taxpayers will be treated as having substantially complied with the requirements of section 1.1042-1T of the Temporary Income Tax Regulations.

Section 1042(a) of the Code provides that a taxpayer or executor may elect in certain cases not to recognize long-term capital gain on the sale of "qualified securities" to an ESOP (as defined in section 4975(e)(7)) or eligible worker owned cooperative if the taxpayer purchases "qualified replacement property" (as defined in section 1042(c)(4)) within the replacement period of section 1042(c)(3) and the requirements of section 1042(b) and section 1.1042-1T of the Temporary Income Tax Regulations are satisfied.

A sale of "qualified securities" meets the requirements of section 1042(b) if: (1) the qualified securities are sold to an ESOP (as defined in section 4975(e)(7)), or an eligible worker owned cooperative; (2) the plan or cooperative owns (after application of section 318(a)(4)), immediately after the sale, at least 30 percent of - a) each class of outstanding stock of the corporation (other than stock described in section 1504(a)(4)) which issued the securities, or (b) the total value of all outstanding stock of the corporation (other than stock described in section 1504(a)(4)); (3) the taxpayer files with the Secretary a verified written statement of the employer whose employees are covered by the ESOP or an authorized officer of the cooperative consenting to the application of section 4978 and 4979A with respect to such employer or cooperative; and (4) the taxpayer's holding period with respect to the qualified securities is at least 3 years (determined as of the time of the sale).

Section 1042(c)(1) provides that the term "qualified securities" means employer securities (as defined in section 409(l)) which are issued by a domestic C corporation that has no stock outstanding that is readily tradable on an established securities market; and were not received by the taxpayer in a distribution from a plan described in

section 401(a), or in a transfer pursuant to an option or other right to acquire stock to which section 83, 422 or 423 applied.

The taxpayer must purchase "qualified replacement property" within the "replacement period" which is defined in section 1042(c)(3) as the period which begins 3 months before the date on which the sale of qualified securities occurs and ends 12 months after the date of such sale.

Section 1042(c)(4)(A) defines "qualified replacement property" (QRP) as any security issued by a domestic operating corporation which did not, for the taxable year preceding the taxable year in which such security was purchased, have passive investment income (as defined in section 1362(d)(3)(D)) in excess of 25 percent of the gross receipts of such corporation for such preceding taxable year; and is not the corporation which issued the qualified securities which such security is replacing or a member of the same controlled group of corporations (within the meaning of section 1563(a)(1)) as such corporation.

Section 1.1042-1T (Q&A-3) of the Temporary Income Tax Regulations states that the election shall be made in a "statement of election" attached to the taxpayer's income tax return filed on or before the due date (including extensions of time) for the taxable year in which the sale occurs.

Section 1.1042-1T (Q&A-3) of the Temporary Income Tax Regulations states that the "statement of election" shall provide that the taxpayer elects to treat the sale of securities as a sale of qualified securities under section 1042(a), and shall contain the following information:

- (1) A description of the qualified securities sold, including the type and number of shares;
- (2) The date of the sale of the qualified securities;
- (3) The adjusted basis of the qualified securities;
- (4) The amount realized upon the sale of the qualified securities;
- (5) The identity of the ESOP or worker-owned cooperative to which the qualified securities were sold;
- (6) If the sale was part of a single interrelated transaction under a prearranged agreement between taxpayers involving other sales of qualified securities, the names and taxpayer identification numbers of the other taxpayers under the agreement and the number of shares sold by the other taxpayers.

Section 1.1042-1T (Q&A-3) of the Temporary Income Tax Regulations further provides that if the taxpayer has purchased qualified replacement property at the time of the election, the taxpayer must attach as part of the statement of election a "statement of purchase" describing the qualified replacement property, the date of the purchase, and the cost of the property, and declaring such property to be qualified replacement property with respect to the sale of qualified securities. The statement of purchase must be notarized no later than 30 days after the purchase.

Literal compliance with procedural directions in Treasury regulations on making elections is not always required. See *Hewlett-Packard v. Commissioner*, 67 T.C. 736, acq. in result 1979-1 C.B. 1. Regulatory requirements that relate to the substance or the essence of the statute, on the other hand, must be complied with strictly.

With respect to the present ruling request, Taxpayers were not aware of the 30 day notarization requirement for purchases of qualified replacement property and were not informed of it by tax professionals upon whom they had relied for advice on the ESOP transaction until after some purchases of qualified replacement property had already been made. Taxpayers requested relief before the expiration of the time for filing the return on which the election must be made. All purchases of QRP were made within the qualified replacement period with respect to the ESOP sale. Upon learning of the notarization requirement, statements of purchase for subsequent purchases of QRP were notarized within 30 days of the date of purchase and notarized statements of purchase were executed for previous purchases of QRP.

Therefore, based on the specific facts of this case and representations made by Taxpayers, we conclude that Taxpayers have substantially complied with the requirements of section 1.1042-1T of the Temporary Income Tax Regulations with respect to the Taxpayers' 2002 sale of qualified securities to the ESOP.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayers.

The rulings contained in this letter are based upon information and representations submitted by the taxpayers and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely yours,

Robert D. Patchell
Chief, Qualified Plans Branch 2
Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosure:
Copy for 6110 purposes

cc: