

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200946006**

Release Date: 11/13/2009

Index Number: 1033.00-00, 1033.04-00

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:05
PLR-105863-09
Date: July 29, 2009

LEGEND:

- Taxpayer =
- Corporation A =
- Corporation B =
- State =
- Date 4 =
- Date 3 =
- Date 2 =
- Date 1 =
- \$\$\$ =

Dear

In a letter dated January 27, 2009, you requested a private letter ruling on behalf of Taxpayer under Revenue Procedure 2008-1. You asked that, pursuant to section 1033(a) of the Internal Revenue Code, Taxpayer not be required to recognize gain from a putative involuntary conversion of certain corporate stock which escheated to State and was sold thereby under State's abandoned property laws, provided Taxpayer reinvests the proceeds from the sale of such stock it received on Date 1 in qualifying replacement property by the close of Taxpayer's taxable year on Date 4. You further requested that, for purposes of this ruling, qualified replacement property under section 1033 would include shares of publicly traded common or preferred stock of U.S. or foreign companies and shares of U.S mutual funds.

FACTS

Taxpayer is a family limited partnership holding investments for the benefit of the partners. The original assets of Taxpayer were in the form of corporate stock in Corporation A. Corporation A was ultimately acquired by Corporation B, a publicly traded company, which distributed its stock to Corporation A shareholders. The transaction was structured by Corporation B so that approximately 75% of its stock was distributed directly to the shareholders upon surrender of their certificates, and two escrow accounts were set up holding back a percentage (the remaining approximately 25%) of Corporation B stock for each shareholder. One escrow was distributed after approximately one year. Taxpayer never received the distribution from the second escrow.

Prior to the second escrow release, the original trustee of Taxpayer died. When a new trustee was appointed (the current trustee), the existence of the stock in the escrow account was unknown to that new trustee. Apparently, any attempted communication or delivery by the escrow agent to the deceased former trustee would have been returned to the escrow agent.

At a subsequent unknown date, the escrow agent transferred the shares remaining in the escrow account owed to Taxpayer to the State in accordance with the State's unclaimed property law. The State sold the shares on Date 3 for \$\$\$ and retained control of the cash proceeds, publishing its holding of the funds as unclaimed property. On or about Date 2, the current trustee was made aware by a third party of the State's holding of the unclaimed property, and the trustee placed a claim for it with State. The State subsequently transferred the proceeds to Taxpayer's brokerage account on Date 1.

LAW AND ANALYSIS

Overview

Section 61(a) indicates that, except as otherwise provided in the income tax provisions of the Code, gross income means all income from whatever source derived. Gains from dealings in property are included among the specifically listed items included in gross income. Section 61(a) (3).

Section 1033(a)(2)(A) allows a taxpayer to make an election to limit current recognition of gain with respect to property that (as a result of destruction, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into money. The recognized gain is limited to the excess of

the amount realized upon such conversion over the cost of other property (hereinafter referred to as qualified replacement property) similar or related in service or use to the converted property (or the cost of purchasing stock in the acquisition of control of a corporation owning such other property), purchased by the taxpayer within a specified period. Section 1033(a) (2) (B) generally requires the replacement property to be purchased during the period beginning with the date of the disposition of the converted property, or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is the earlier, and ending 2 years after the close of the first taxable year in which any part of the gain upon the conversion is realized.

State's Escheat Law and Its Operation

Pursuant to the law of State, if certain jurisdictional requirements are satisfied, corporate common stock escheats to State if the apparent owner of the stock, as determined from the corporate records, for more than 3 years neither claims a dividend on the stock nor corresponds with the corporation or otherwise indicates an interest in the corporation as evidenced by a corporate record. In addition, for escheat to be required the corporation must not know the location of the owner at the end of the 3 year period referred to in the preceding sentence.

The corporate issuer of the stock to be escheated (the issuer) must file a report with State Commissioner (the commissioner) that identifies the stock to be escheated. If known to the issuer, the report must also contain the name and the last known address, if there is one, of the person or persons that appear from the corporate records to be the owners of the stock. State requires the issuer to transfer the escheated stock to the commissioner when the report is filed.

Prior to transferring the escheated stock to the commissioner, the issuer must make reasonable efforts to notify the apparent owner by mail of the impending escheat. State law generally requires the issuer to transfer the stock to the commissioner by issuing a duplicate certificate (in the name of the commissioner if possible) to the commissioner. The duplicate certificate replaces the certificate issued to the apparent owner.

Within the calendar year next following the year of receiving the escheated stock, State law requires the commissioner to provide public notice in the manner and frequency the commissioner determines to be most effective and efficient in communicating to the persons appearing to be owners of the escheated property. This notice may be by print, broadcast, or electronic media; however, the required notice is simply a general notice to all potential owners of unclaimed property. The notice does not have to identify the escheated property nor the apparent owner of the property. The notice is only required to contain a statement that information concerning the

description or amount of escheated property held by the commissioner may be obtained by persons possessing an interest in such property by contacting the commissioner. Only if certain conditions are satisfied does State law require the commissioner to attempt to mail a notice to the apparent owner of particular property escheated. State law does not specify what the mailed notice must contain.

Upon delivery to the commissioner, State takes custody of the escheated stock and becomes responsible for its safekeeping. Dividends received by the commissioner or accrued on the escheated stock from the time of its receipt by the commissioner until the commissioner sells the escheated stock are credited, upon receipt by the commissioner, to the apparent owner's account. If the escheated stock is traded on an established stock exchange, State law requires the commissioner to sell the stock at the exchange price.

State requires the commissioner to deposit dividends on the escheated stock, as well as the net proceeds from the sale of such stock into the State's general fund. Earnings on the deposited amounts, however, do not accrue to the credit of the apparent owners of the escheated property. State is not required to pay any interest on claims pertaining to escheated property. Consequently, State obtains the use of funds derived from escheated property without any obligation to compensate the apparent owners of the escheated property for that use.

State law provides for a comprehensive system of escheat. "Escheat" within the meaning of the State statutes consists of a custodial taking of property rather than the transfer of all ownership rights to the state. The owner of property escheated to State may file a claim for such property, or the net proceeds from the sale of such property, at any time. The commissioner is required to consider the claim within 90 days time after it is filed. In doing this the commissioner may hold a hearing and receive evidence regarding the claim. If the commissioner denies a claim in whole or in part, or fails to make a decision on such claim within 90 days time, the claimant may assert the claim in a State court.

Section 1033(a) Elements: Seizure

Whether the taking of stock by State pursuant to State's unclaimed property law falls within one of the conversions within section 1033(a), specifically, destruction, theft, seizure, requisition or condemnation or threat or imminence thereof, constitutes the threshold issue to be resolved.

One possibility is that State's actions amounted to a "seizure." Section 1033 provides no definition of the term "seizure." The provisions found in section 1033 extend back to the Revenue Act of 1921. Neither the legislative history to that act or to subsequent

acts amending section 1033 or its predecessor provisions sets forth guidance regarding the specific meaning of the term "seizure."

Rev. Rul. 79-269, 1979-2 C.B. 297, however, discusses the term "seizure" for section 1033 purposes. That ruling distinguishes the seizure of property from its requisition or condemnation as follows:

The courts have interpreted the term requisition or condemnation to mean the taking of property by a government authority that has the power to do so against the will of the owner and for the use of the taker. [Citations omitted] This interpretation limits the definition of the term to the taking of property for public use.

A seizure occurs when a government authority enters into physical possession of property without authority of a court order with compensation to be determined later. This is different from a requisition or condemnation under which the government pays judicially determined compensation before it takes property, or it takes property under court order before the amount of compensation has been determined. [Citation omitted.] But a seizure is like a requisition or condemnation in that it is limited to the taking of property for public use.

Upon the sale of stock by State, its law required the commissioner to deposit the proceeds into the State's general fund. It follows that money deposited in the general fund is expended for State purposes. Moreover, State was not required to pay Taxpayer interest on the proceeds from the sale of Taxpayer's seized stock nor was Taxpayer entitled to any earnings State derived from such proceeds. Regardless of whether a seizure occurred prior to State's sale of the stock, once State sold the stock the proceeds were held for public use and there was a completed seizure of Taxpayer's property within the meaning of section 1033(a).

Involuntary Conversion into Money

Section 1033 only defers gains resulting from compulsory or involuntary conversions. The conversion into money or other property must occur from circumstances beyond the taxpayer's control. C. G. Willis, Inc. v. Commissioner, 41 T.C. 468, 474 (1964), aff'd per curiam, 342 F.2d 996 (3d Cir. 1965). Thus, in an extreme example, a taxpayer who, in an attempt to obtain insurance proceeds, commits arson by voluntarily paying a third party to burn down the taxpayer's building is not entitled to the benefits of section 1033. Rev. Rul. 82-74, 1982-1 C.B. 110.

In perhaps a more routine example, in Rev. Rul. 69-654, 1969-2 C.B. 162, the Service concluded that a property owner who voluntarily consented to the subsequent conversion of part of his property for the purpose of constructing a school as a condition to receiving approval for the development of his remaining property was not entitled to the tax benefits of section 1033 with regard to the sale of the land on which the school would be constructed. Therefore, if a taxpayer takes voluntary action to cause the conversion of the taxpayer's property into other property or money, such a conversion does not constitute an involuntary conversion within the meaning of section 1033.

Taxpayer represents that it did not intentionally fail to exercise ownership rights with regard to its stock for the purpose of having such stock transferred to and sold by the commissioner pursuant to State's unclaimed property law. Assuming this representation to be true, Taxpayer should not be precluded from the tax benefits of section 1033 because of the requirement that conversion be involuntary.

Taxpayer's trustee represents that to the best of his knowledge he did not receive a letter or other notification from Corporation B informing of the pending transfer of stock prior to Corporation B transferring Taxpayer's holdings to State. The trustee also represents that he did not receive any notice from State that it had taken custody of Taxpayer's Corporation B stock prior to its sale by State, nor did State notify him that it was going to sell such stock prior to its sale. Under such circumstances an argument still might be advanced that the trustee was negligent in not taking notice of the State's escheat provisions and in failing to take action to prevent the escheat of Taxpayer's stock. We find these arguments unnecessary to address in the context of ruling on this matter because negligence on the trustee's part, even if it were proved, would not preclude the application of section 1033 to any gain from the sale of Taxpayer's stock by State. Consequently, we find the involuntary element of the statute met.

Replacement Period

Section 1033(a)(2)(B)(i) generally requires a taxpayer to purchase qualifying replacement property by the close of the period ending 2 years after the close of the first taxable year in which any part of the gain upon the conversion is realized.

In Casalina Corp. v. Commissioner, 60 T.C. 694 (1973), aff'd per curiam, 511 F.2d 1162 (4th Cir. 1975) a corporation that was engaged in the real estate business had three tracts of its land condemned by the federal government. The commissioner argued that the taxpayer did not qualify for nonrecognition of gains under section 1033 because of its failure to reinvest proceeds within the prescribed period. The court held that the taxpayer was not entitled to the nonrecognition provisions of section 1033,

because the gains were realized on the condemnation awards when the National Park Service (the condemning authority) made deposits into court for the benefit of taxpayer during the condemnation proceedings. The taxpayer had free access to these funds and made actual withdrawals for its own unrestricted use during that period.

To similar effect, in R.A. Stewart & Co. v. Commissioner, 57 T.C. 122 (1971), city condemned taxpayer's property in 1965 and made an advance payment with respect to the property that year, a payment which taxpayer was free to expend. Since that advance payment exceeded taxpayer's basis in the property, the Tax Court found that the taxpayer realized gain in that year and therefore the running of the period in which the property could be replaced tax-free under the nonrecognition provisions of section 1033 had begun to run in that earliest year.

Similarly, Taxpayer realized gain at the time it had unrestricted access to the money into which that property had been converted. Therefore, Date 1, at which time State yielded its interest in the cash money proceeds of the sold property, should be considered as the beginning of the 2-year replacement period.

Qualified Replacement Property

Generally, replacement property does not qualify as "similar or related in service or use" unless its physical characteristics and end uses are similar to those of the converted property. When an investor owns property that is involuntarily converted, however, the inquiry shifts primarily to the similarity in the relationship of the services or uses which the converted and replacement properties have to the owner-investor.

Revenue Ruling 64-237, 1964-2 C.B. 319, discusses several factors to consider in determining whether the replacement property is similar to the converted property of the owner-investor, including the nature of the business risks connected with the properties, and the extent and type of management activities the property requires of the owner. Thus, when an investor's property is involuntarily converted, the investor is entitled to consider the manner in which the converted property was held in determining whether the proposed replacement property will be similar or related in service or use.

The Service generally does not distinguish among various types of equity securities for purposes of section 1033. Rev. Rul. 66-355, 1966-2 C.B. 302, holds that a taxpayer can replace common stock that was involuntarily converted with common stock, preferred stock, or mutual fund shares and treat the replacement property as similar or related in service or use within the meaning of section 1033. Foreign stock is not outside the scope of the nonrecognition provisions of section 1033.

Taxpayer owned stock in Corporation B for investment purposes. The risks to and activities required of Taxpayer with respect to stock in Corporation B are comparable to the risks of investing in other publicly traded common and preferred stock and stock in publicly traded mutual funds. An investment in debt instruments, however, would not be similar or related in service or use to converted capital stock for purposes of section 1033.

CONCLUSION AND RULING

Taxpayer is entitled to avail itself of the nonrecognition provisions of section 1033 by replacing the “escheated” seized stock in issue sold by State and involuntarily converted into money with qualified replacement property within the authorized 2-year replacement period which, pursuant to this ruling, will have begun to run when the proceeds of the State’s sale were made available to Taxpayer and, on the basis of the factual representations made in the ruling request, we calculate will expire at the close of Taxpayer’s taxable year on Date 4.

A copy of this letter must be attached to any income tax return to which it may be relevant. Taxpayers filing their return electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of this letter ruling.

This ruling is directed solely to the taxpayer requesting it and is based upon the factual representations made in the ruling request. Except as expressly provided herein, no opinion is expressed or implied as to the tax consequences of any aspect of any transactions or items discussed or referenced in this letter. Section 6110(k)(3) of the Internal Revenue Code provides that this letter may not be used or cited as precedent.

In accordance with the provisions of a power of attorney currently on file, we are sending a copy of this letter to the authorized representative of the Taxpayer.

Sincerely,

John M. Aramburu
Senior Counsel, Branch 5
Office of Associate Chief Counsel
(Income Tax & Accounting)