

Internal Revenue Service

Department of the Treasury

Number: **200234003**
Release Date: 8/23/2002
Index Number: 1042.00-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:TEGE:EB:QP2-PLR-146362-01

Date:

01-03-2002

LEGEND

Taxpayer =

Individual A =

Individual B =

Company =

ESOP =

Advisors =

Trustee =

State X =

\$ Y =

\$ Z =

\$ Z1 =

\$ Z2 =

Dear

This responds to your letter requesting a ruling on behalf of the above-named Taxpayer regarding their substantial compliance with the requirements of section 1042 of the Internal Revenue Code of 1986 (Code) and the applicable regulations in connection with the sale of qualified securities of the Company to the employee stock ownership plan (ESOP) maintained by the Company.

The Taxpayer is a trust in State X established on _____ Bank and Individual A are co-trustees of the Taxpayer. The Taxpayer files its federal income tax return on Form 1041 on a calendar year basis.

The Company is a domestic corporation that has only ever had one class of common stock outstanding to the ESOP and at present. On _____, the company adopted an ESOP intended to be qualified under sections 401(a) and 4975(e)(7) of the Code. On _____, the taxpayer sold _____ shares of common stock of the company to the ESOP for a purchase price of \$ X pursuant to a letter of direction from Individual A. At the time of the ESOP transaction, the Company had no stock outstanding that was readily tradable on an established securities market.

The Company maintains an ESOP which is qualified under section 401(a) and meets the requirements of section 4975(e)(7) of the Code. The ESOP has received a favorable determination letter from the Internal Revenue Service regarding the qualification of the plan.

As a result of the sale, the Taxpayer realized a gain. At the time of the sale the Taxpayer's holding period for the stock was more than _____ years. The Taxpayer had received the stock upon the death of individual B on _____. The Taxpayer did not receive 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 or 423 applied. After the sale of the stock by Taxpayer, the ESOP owned more than 30% of the outstanding stock of the Company. When the Taxpayer sold its shares of company stock to the ESOP, it intended to make an election under section 1042 to defer recognition of the entire gain from the ESOP transaction.

Pursuant to the Taxpayer's plan to acquire qualified replacement property (QRP) (as defined in section 1042(c)(4)), within the qualified replacement period, the Bank used funds the Taxpayer received in the ESOP transaction to purchase from _____, through _____, in a series of _____ transactions on behalf of the Taxpayer, securities of domestic operating companies with an aggregate purchase price of \$ Z. The trustees intended that these securities would constitute qualified replacement property (QRP). The trustees were responsible for the investment of the proceeds of the ESOP transaction into QRP. On _____, the company issued a statement of consent consenting to the application of sections 4978 and 4979A.

The trustees were relying on Advisors, who had structured the ESOP transaction, to advise them regarding the requirements of section 1042. Advisors had been long- time counsel for Individuals A and B, the company and the taxpayer. However, Advisors did not inform the trustees of the requirement under section 1.1042-1T of the temporary income tax regulations that notarized statements of purchase be executed within 30 days of the purchase of the QRP. As a result, when the Trustees began purchasing QRP for the Taxpayer, they were not aware of this requirement.

In _____, in connection with the preparation of the Taxpayer's

income tax return, and before the Trustees purchased the remainder of the QRP, the Trustees became aware of the notarized statement of purchase requirement. On _____, after becoming aware of the requirement to execute notarized statements of purchase for the QRP, the Bank's trust officers for the Taxpayer executed notarized statements of purchase covering the securities purchased between _____ and _____. A trust officer also executed on _____ a timely notarized statement of purchase for securities purchased in a series of 27 transactions occurring between _____ with an aggregate purchase price of \$Z1. On _____ a trust officer executed a timely notarized statement of purchase for securities purchased in a series of _____ transactions occurring between _____ and _____ with an aggregate purchase price of \$Z2. The taxpayer represents that the purchases of QRP described above were the only purchases of QRP made by the taxpayer during the qualified replacement period with respect to the sale of employer securities to the ESOP.

The Taxpayer filed for an automatic extension of time until _____ for filing its _____ income tax return and received an additional extension to _____. On _____ the Taxpayer filed its Form 1041 for its _____ taxable year accompanied by a statement of election as described in Q&A-3 of section 1.1042-1T of the Temporary Income Tax Regulations; notarized statements of purchase with respect to QRP described above and a verified written statement of the Company consenting to the application of section 4978 and 4979A as required in section 1042(b)(3).

You have requested a ruling, based on the specific facts of this case, that the Taxpayer is in substantial compliance with the requirements for the election of nonrecognition of gain under section 1042 of the Code and that the election will be treated as having satisfied 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 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).

For taxable years beginning after December 31, 1997, 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" 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; and

(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, the Taxpayer requested relief before the expiration of the time for filing the return on which the election must be made. The Taxpayer relied on tax professionals to advise it as to the requirements necessary to complete the section 1042 election in a timely and correct manner. Promptly upon discovering that the statements of purchase were not notarized in a timely manner, and prior to the expiration of the time to file the Taxpayer's Income Tax Return, the Taxpayer completed a notarized statement of purchase for QRP purchased from through Notarized statements of purchase were executed within 30 days of purchase for QRP purchased between and and between and

Therefore, based on the specific facts of this case and representations made by the Taxpayer, we conclude that the Taxpayer is in substantial compliance with the requirements for the election of nonrecognition of gain under section 1042 of the Code and that the election will be treated as having satisfied the requirements of section 1.1042-1T of the temporary Income Tax Regulations.

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 taxpayer 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 Taxpayer's representative.

The rulings contained in this letter are based upon information and

representations submitted by the taxpayer 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
Acting Chief, Qualified Plans Branch 2
Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures:

Copy of this letter

Copy for 6110 purposes