

**Internal Revenue Service**

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:TEGE:EB:QP2-PLR-125776-02

Date:

August 15, 2002

LEGEND

Shareholder =

Company =

ESOP =

Law Firm =

Date D =

X =

Dear :

This responds to your letter of March 19, 2002, requesting a ruling on behalf of the above-named Shareholder regarding his 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.

According to your representations, the Shareholder owned shares of Class B common stock of the Company, a domestic C corporation that has never had any stock outstanding that was readily tradable on an established securities market. The Company maintains an ESOP which qualifies under section 401(a) and meets the requirements of section 4975(e)(7) of the Code.

On Date D, the Shareholders sold X shares of Class B common stock of the Company to the ESOP. As a result of the sale, the Shareholder realized a capital gain. The Shareholder had held the common stock for more than 3 years prior to the ESOP sale and 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 or 423 applied. 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)).

The Shareholder invested the proceeds from the sale in securities issued by domestic operating companies. During the authorized period for purchasing qualified replacement property (QRP), the Shareholder made a number of purchases of securities that he intended to constitute QRP as defined in section 1042(c)(4).

In connection with the ESOP transaction, the Law Firm informed the Shareholder regarding the procedural requirements of Q&A-3 of § 1.1042-1T of the Temporary Income Tax Regulations regarding the required statements of purchase. However, after receiving the statement of purchase forms from his broker, the Shareholder executed several of the statements of purchase, but inadvertently neglected to have them notarized within 30 days of purchase as required under § 1.1042-1T. After the Firm received the statements of purchase in question, it notified the Shareholder of the requirement to have them notarized. Shortly afterward, the Shareholder completed the required notarized statements of purchase for the QRP purchases in question, before the expiration of the replacement period. In addition, the Shareholder had the other statements of purchase properly notarized in accordance with the procedural requirements of § 1.1042-1T (Q&A-3).

After filing this request for a private letter ruling, the Shareholder filed an extension of time to file his U.S. Individual Income Tax Return for the 2001 taxable year and will file timely by the extended due date. On his return, the Shareholder intends to elect under section 1042(a) to defer recognition of gain from the sale of qualified securities to the ESOP. With his income tax return, the Shareholder plans to submit the following documents: 1) a Statement of Election as described in Q&A-3 of § 1.1042-1T, 2) notarized statements of purchase with respect to the qualified replacement property, as described in Q&A-3 of § 1.1042-1T, and 3) 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 that, based on the specific facts of this case, the Shareholder has substantially complied with the requirements for an election to defer recognition of gain under section 1042 of the Code, and that the election will be treated as satisfying the requirements of section 1042 and § 1.1042-1T (Q&A-3).

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 § 1.1042-1T 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 sections 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" (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) also 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) 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.

The Shareholder received the advice of a tax professional concerning the requirements necessary to complete the section 1042 election in a timely and correct manner. Promptly upon being informed that certain statements of purchase had not been notarized as required, the Shareholder completed notarized statements of purchase for the relevant qualified replacement property, before the expiration of the replacement period.

Therefore, based on the specific facts of this case and representations made in your correspondence, we conclude that the Shareholder has substantially complied with the requirements for an election to defer recognition of gain under section 1042 of the Code, and that the election will be treated as satisfying the requirements of section 1042 and § 1.1042-1T (Q&A-3) 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. No opinion is expressed regarding whether the securities purchased by the Shareholder constitute qualified replacement property as defined in section 1042(c)(4).

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. The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings, and 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