Internal Revenue Service

Number: **200906009**
Release Date: 2/6/2009

Index Number: 9100.00-00, 1045.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:ITA:B05
PLR-119906-08
Date:
October 24, 2008

TYs:

Legend:

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Company 1 =

Company 2 =

Market =

Exchange =

Month 1 =

Representative 1 =

Representative 2 =

State 1 =

Taxpayer =

Year 0 =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

Year 6 =

Year 7 =

n =

o =

p =

q =

r =

s =

t =

u =

v =

Dear :

This letter is in response to your request under § 301.9100-1 and -3 of the Procedure and Administration Regulations for an extension of time to elect the application of §1045 of the Internal Revenue Code to defer the recognition of gain realized on the sale of qualified small business stock (“QSBS”).

Facts:

In early February of Year 6, the Taxpayer was notified that his Form 1040 Individual Income Tax Return ("Form 1040") for Year 3 had been selected for audit. During the Revenue Agent's pre-audit analysis and research, he discovered that the Taxpayer was a founder of Company 1 and had sold stock of Company 1 during Year 3. The Taxpayer failed to report $o in sales of Company 1 stock on his Year 3 Form 1040. Based on the Taxpayer's unreported sales of Company 1 stock, false statements by Representative 1, and Representative 1's actions intended to impede the audit and frustrate the Revenue Agent's attempts to obtain needed information, the audit was expanded to include the Taxpayer's tax returns for Year 4 and Year 5. After receiving approval of Area Counsel concerning the applicability §6501(e) of the Code, the Taxpayer's tax returns for Year 0, Year 1, and Year 2 were also included in the audit. The Revenue Agent provided information indicating that the examination of the returns for Year 0 through Year 2 resulted in discovery of $v in sales of Company 1 stock during each year which would not have qualified for deferral of recognition of gain, even if the Taxpayer had made a timely election for application of §1045, since he did not purchase replacement QSBS stock within 60 days of the respective sales. The Taxpayer's tax return for Year 6 was not examined.

Company 1 was incorporated under the laws of State 1 in Month 1. On Date 1, the Taxpayer purchased "n" shares of Company 1 at a price of $p per share. The stock of Company 1 was initially traded on the Market. The stock was subsequently listed on the Exchange where it (its successor) currently trades.

It has been represented that at all times during its existence, Company 1 has been a "C" corporation and has met the active business requirement of §1202(e) of the Code. It has also been represented that the stock of Company 1 has, at all times satisfied the criteria provided in §1202(c) for characterization as QSBS.

In Year 0, the Taxpayer co-founded Company 2. Company 2 was organized under the laws of State 1. It has been represented that at all times during its existence Company 2 has been a "C" corporation and has met the active business requirement of §1202(e) of the Code. It has also been represented that the stock of Company 2 has, at all times satisfied the criteria provided in §1202(c) for characterization as QSBS.

An affidavit provided by the Taxpayer indicates that during Year 3 and Year 4, he realized $r from the sale of q shares of Company 1 stock. Most of those sales, as well as sales of Company 1 stock in Year 0 and Year 1, either were not reported or were improperly reported on the Taxpayer's Form 1040 for the year in which the respective sales took place. In both Year 2 and Year 4, the Taxpayer claimed a loss on sales of Company 1 stock The reported losses were the result of using an amount significantly in excess of the Taxpayer's actual basis of the stock sold as the basis for the purpose of determining gain (loss); the Taxpayer actually realized significant gains on the sales.

During the period beginning on Date 2 and ending with Date 3, the Taxpayer purchased "s" shares of Company 2 stock at an aggregate cost of $t. Based on the information provided, the amount of Company 2 stock which the Taxpayer purchased in Year 4 and Year 5 may have been sufficient to support deferral of the gain the Taxpayer realized on the sale of Company 1 stock in the respective years if the Taxpayer had elected the application of §1045.

An affidavit provided by the Taxpayer includes the following statement: "I was informed and believed based upon conversations with a sophisticated investor, shareholder and director of Company 1, that I could roll over the gain from the sale of stock in one start-up company to another without recognizing gain. Prior to Date 4, however, I was not aware of the necessity of making an election on my tax returns to qualify for such treatment." The affidavit also includes a statement acknowledging the Taxpayer's acquisition of "n" shares of stock of Company 1 at a cost of $p per share.

In the affidavit, the Taxpayer states that he reported no gain from sales of Company 1 stock in Year 4 and Year 6. Schedule D of a copy of an unsigned Year 6 Form 1040 included in the Taxpayer's request for relief includes an entry to report gain on a $u sale of Company 1 stock (under its name at the time). Schedule D of a copy of an unsigned Year 4 Form 1040 included in the request for relief includes an entry to claim a loss on sale of Company 1 stock in Year 4. The Taxpayer's Year 6 Form 1040 was not audited. Consequently, it is not possible to determine whether the copy of an unsigned Year 6 Form 1040 included with the request for relief is a copy of the Form 1040 the Taxpayer filed for Year 6. Similarly, the accuracy of the information reported on the copy of the Form 1040 could not be verified. Where the information in the Taxpayer's affidavit was inconsistent with information shown on copies of unsigned Form 1040s, the information on the Taxpayer's affidavit, rather than that shown on copies of unsigned tax returns, was considered to be accurate.

In December of Year 7, the Taxpayer consulted with Representative 2 with respect to the pending audit of his Form 1040s for Year 3 and Year 4. Several days after their initial meeting, Representative 2 informed the Taxpayer of the necessity of electing the application of §1045.

The Taxpayer employed Representative 1, an enrolled agent, to prepare his Form 1040 for Year 3, Year 4, and Year 6. The information provided does not indicate that the Taxpayer informed Representative 1 that he was a co-founder of Company 1; that he purchased stock of Company 1 at original issuance; or that he believed he could rollover gain from the sale of stock of Company 1 to stock purchased in another startup company. Representative 1 was apparently unaware of § 1045 and apparently did not timely advise the Taxpayer of the necessity to elect the application of §1045 for years in which he sold QSBS. Consequently, the Taxpayer did not elect the application of §1045 for Year 3 or Year 6. Based on the loss reported on the sale of Company 1 stock

in Year 4, there would have been no reason to elect the application of §1045 for that year.

Representative 1 provided an affidavit in which he states that he was not aware of the procedure prescribed by Rev. Proc. 98-48, 1998-2 C.B. 367 for electing the application of §1045.

APPLICABLE LAW AND ANALYSIS:

Section 1045(a) provides, in part, that in the case of any sale of qualified small business stock held by a taxpayer other than a corporation for more than 6 months and with respect to which such taxpayer elects the application of this section, gain from such sale shall be recognized only to the extent that the amount realized on such sale exceeds --

(1) the cost of any qualified small business stock purchased by the taxpayer during the 60-day period beginning on the date of such sale, reduced by

(2) any portion of such cost previously taken into account under this section.

The time and manner for making the election allowed by section 1045(a) is prescribed by Rev. Proc. 98-48, 1998-2 C.B. 367. Under the revenue procedure the election must have been made no later than the due date (including extensions) for filing the tax return for Tax Year 1 and for Tax year 2.

Section 1045(b)(1) provides that the term "qualified small business stock" has the meaning given such term by section 1202(c). Section 1202(c)(1)(B) provides as one of the defining characteristics of qualified small business stock that it be acquired by the taxpayer at its original issue (directly or through an underwriter) in exchange for money or other property or in exchange for services provided to such corporation was acquired.

Based on the information and representations provided by the Taxpayer and the forgoing analysis, it appears that recognition of the gains realized on the sale of Company 1 stock in Year 3, Year 4, and Year 6 could have been deferred under § 1045 if the amount realized had been timely reinvested in other QSBS and the Taxpayer had made a timely election to have § 1045 apply.

Sections 301.9100-2 and 301.9100-3 provide the standards the Commissioner uses to determine whether to grant an extension of time to make a regulatory election. An extension of time is available for elections that a taxpayer is otherwise eligible to make. However, the granting of an extension of time to make elections is not a determination that the taxpayer is otherwise eligible to make one.

The Taxpayer has requested relief in the form of a grant of an extension of time to make a regulatory election pursuant to the provisions of §301.9100-3. For this purpose, §301.9100-1(b) defines the term regulatory election to include an election whose deadline is prescribed by a regulation published in the Federal Register, or a revenue ruling, revenue procedure, or notice or announcement published in the Internal Revenue Bulletin.

Section 301.9100-3(a) provides, in part, that requests for relief will be granted when the taxpayer provides evidence (including affidavits described in paragraph (e) of this section) to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the government.

Section 301.9100-3(b)(1) provides, in part, that except as otherwise provided (in paragraphs (b)(3)(i) through (iii) of that section), a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer "(i) Requests relief under this section before failure to make the regulatory election is discovered by the IRS; . . . or (v) Reasonably relied on a qualified tax professional . . . and the tax professional failed to make, or advise the taxpayer to make, the election."

The Taxpayer's request for relief under § 301.9100-3(c) was filed more than two years after the Internal Revenue Service discovered that the Taxpayer had failed to report sales of Company 1 stock and reported losses on other sales on which he actually realized gains. The Taxpayer's request for relief under § 301.9100-3(c) was filed more than 4 months after Representative 2 advised him of the necessity of electing the application of §1045.

Section 301.9100-3(b)(3) provides, in part, that a taxpayer is deemed to have not acted reasonably and in good faith if the taxpayer (i) seeks to alter a return position for which an accuracy-related penalty has been or could be imposed under section 6662 at the time the taxpayer requests relief (taking into account any qualified amended return filed within the meaning of section 1.6664-2(c)(3)) and the new position requires or permits a regulatory election for which relief is requested; (ii) was informed in all material respects of the required election and related tax consequences, but chose not to file the election; or (iii) uses hindsight in requesting relief. In connection with hindsight, if specific facts have changed since the due date for making the election that make the election advantageous to the taxpayer, the IRS will not ordinarily grant relief. In such a case, the IRS will grant relief only when the taxpayer provides strong proof that the taxpayer's decision to seek relief did not involve hindsight.

The Taxpayer seeks to alter return positions (unreported sales and improperly reported sales) for which accuracy-related penalties had been imposed under §6662 at the time the Taxpayer requested relief. The new positions require regulatory elections for which relief is requested. The Taxpayer seeks relief in the form of a grant of additional time to

elect the application of §1045 to sales of Company 1 stock that he either did not report or that he improperly reported as having resulted in losses.

Section 301.9100-3(c)(1)(ii) provides, in part, that the interests of the government are ordinarily prejudiced if the taxable year in which the regulatory election should have been made, or any taxable years that would have been affected by the election had it been timely made, are closed by the period of limitations on assessment.

The Taxpayer will not have a lower tax liability in the aggregate for any of the years in which the election will apply than Taxpayers would have had if the elections had been timely made (taking into account the time value of money). No taxable year that would be affected by the elections, had they been timely made, is closed by the period of limitations on assessment.

The Taxpayer's Forms 1040 for all of the years for which additional time is requested to elect the application of §1045 were not filed as if timely elections had been made for the application of §1045. On the Year 4 Form 1040, the Taxpayer reported a loss on one or more sales of Company 1 stock on which he, in fact, realized a gain. The Taxpayer failed to report one or more sales of Company 1 stock during Year 3. If timely elections had been made to apply §1045, those sales would have been reported.

If the copy of an unsigned Year 6 Form 1040 included in the request for relief is a copy of the return the Taxpayer actually filed for Year 6 and includes: (i) all of the Taxpayer's Company 1 stock sales during Year 6, (ii) the correct basis of the stock sold, and (iii) the correct sales price of all the Company 1 shares sold, the information reported on the return would be consistent with the entries that would have been made if the Taxpayer had made a timely election for the application of §1045**.** However, in his affidavit, the Taxpayer states that he did not report sales of Company 1 stock on his Year 6 tax return.

Circumstances in which a taxpayer fails to report a sale of QSBS are prejudicial to the interest of the government even if the taxpayer reinvests the amount realized in other QSBS within the 60-day period specified by §1045(a)(1). Failure to report a sale of QSBS deprives the Internal Revenue Service of information it requires to determine whether the taxpayer has properly accounted for any gain (loss) on the sale of the QSBS and, if the taxpayer has purchased replacement QSBS, reduced the basis of the replacement QSBS by the amount of the gain that was not recognized gain on the sale of the QSBS stock. Failure to report the gain from a sale of property, e.g., QSBS stock, is generally indicative of an intent to evade tax on the gain**.** Unless the taxpayer's return is audited and the unreported gain is discovered, the unreported gain escapes taxation. A position that would provide relief in the form of a grant of additional time to make an election for application of §1045 with respect to unreported sales or improperly reported sales, e.g., losses reported on transactions that resulted in gains, would eliminate the adverse consequences of such actions. Taxpayers would have an incentive not to

report sales of QSBS which resulted in gains and take their chances on the audit lottery. If their return was not audited, they would evade tax on the unreported gain. If the unreported gain was discovered during an audit, the taxpayer would request relief under § 301.9100 for additional time to make an election for application of §1045. Any position that would provide an incentive for taxpayers to take such action is prejudicial to the interest of the government.

The Taxpayer's sales of Company 1 stock in Year 0 and Year 1 illustrate the potential for tax evasion. Information provided by the Revenue Agent indicates that the Taxpayer failed to report sales of QSBS stock, in Year 0 and Year 1, on which he realized gains of $v. The gains would not have qualified for nonrecognition under §1045 since the Taxpayer did not purchase replacement QSBS within the time period specified in §1045(a)(1). If the Taxpayer's tax returns for those years had not been examined, the Taxpayer would have evaded tax on the gain on the unreported sales.

For some of the years involved in the subject case, the Taxpayer indicated that he treated the basis of the QSBS he sold as being equal to the amount of the sales proceeds that he used to purchase replacement QSBS. Such treatment precludes a determination that the Taxpayer realized a gain on the sale of the QSBS. In the absence of a gain, there would be no basis for application of §1045. For example, if the Taxpayer sold 1,000,000 shares of QSBS stock a total of $10,000,000. The basis in the stock that was sold was $0.10 per share. Under the Taxpayer's treatment, the transaction would have been determined to result in no gain or loss:

Sales price	$10,000,000
Reduced by basis – Actual basis of QSB stock sold - $100,000. (Taxpayer treated the amount realized on the sale of QSBS that was used to purchase replacement QSBS stock as the basis of the QSBS stock sold)	10,000,000
Gain (loss) on sale of QSBS	$ - 0 -

The treatment described above results in no indication that a gain was realized on the sale of QSBS stock. Absent a realized gain, there would be no basis for application of §1045 and no reason to reduce the basis of the replacement QSBS. The result would be the evasion of tax on the QSBS stock and the Internal Revenue Service would never be put on notice that the basis of the replacement QSBS was to be reduced by the amount of the unrecognized gain on the sale of the QSBS. Although no current tax liability would be due under a proper application of §1045 if the taxpayer who sold the QSBS used the amount realized to purchase replacement QSBS, the sale would be reported on the taxpayer's tax return for the year in which the sale occurred. As a result of reporting the gain, the Internal Revenue Service would be put on notice that the

basis of other QSBS (replacement QSBS) held by the Taxpayer was subject to reduction by the amount of the gain that was not recognized on the sale of the QSBS.

Circumstances in which a taxpayer reports a loss on a sale of QSBS as a result of claiming a basis significantly in excess of his actual basis in the stock sold may represent an attempt to evade tax. Based on information provided by the Revenue Agent who conducted the audit in this case, the Taxpayer reported losses on sales of Company 1 stock in Year 2 and Year 4 although the sales in each of those years resulted in the realization of gains. Even if the Taxpayer had purchased sufficient replacement QSBS within the time prescribed by §1045(a)(1) to defer recognition of the gain realized on the sale of the QSBS if a timely election had been made for application of §1045, reporting a loss on the sale of the QSBS could have facilitated tax evasion. If the Taxpayer's return had not been audited, the improper reporting of the QSBS sales might not have been discovered by the Internal Revenue Service. The reported losses would have resulted in a reduction of the Taxpayer's tax liability on income that was reported and may have facilitated evasion of tax on the gains realized on the sale of the QSBS either as a result of such gains not being reported or the basis of replacement QSBS stock not being reduced by the amount of the gains on the sale of QSBS stock that were not recognized.

If the Taxpayer's Year 3 Form 1040 had not been selected for audit, the Taxpayer may have been able to evade tax on the gain realized on the sales of Company 1 stock and claim a cost basis in the Company 2 stock when it was sold. Similarly, a taxpayer who did not report a sale of QSBS and either did not purchase sufficient, or any, replacement QSBS stock within the period specified by §1045(a)(1) might be able to evade tax on the gain realized on the sale of the QSBS.

Taken together, the circumstances described above indicate that granting the requested relief in the form of additional time for the Taxpayer to make elections for the application of §1045 to stock sales which it either did not report or reported as resulting in losses when the transactions resulted in the realization of gains would be prejudicial to the interest of the government**.** Accordingly, the Taxpayer's request for relief in the form of an extension of time to make an election for application of § 1045 to sales of Company 1 stock in Year 3 and Year 4 is denied. The request for relief for Year 6 is denied unless the Taxpayer can demonstrate to the satisfaction of personnel in Examination or Appeals that the information reported on the unsigned copy of the Year 6 Form 1040 included in the request for relief is a copy of the Form 1040 he filed for Year 6 and that it correctly reflects all of his sales of Company 1 stock during Year 6 and that such return has not been amended. If the Taxpayer can make such a demonstration, he will be granted additional time to elect the application of §1045 for Year 6.

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

whether the Company 1 stock sold by the Taxpayer or the Company 2 stock purchased by the Taxpayer constituted QSBS(or was otherwise eligible to be treated as such) or whether the other statutory and regulatory prerequisites for deferral under § 1045 were satisfied. This letter is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent. A copy of the letter is enclosed showing the deletions proposed to be made when it is disclosed under §6110.

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 your authorized representative.

Sincerely,

George F. Wright
Senior Technician Reviewer, Branch 5
Office of Associate Chief Counsel
(Income Tax & Accounting)