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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:TEGE:EB:QP1
PLR-122572-09
Date:
December 16, 2009

LEGEND

Taxpayer =

Company =

ESOP =

A =

B =

C =

Date L =

State X =

Dear :

This responds to your letter requesting a ruling on behalf of the above-named taxpayer on the application of section 1042 to certain transactions described below.

According to the facts submitted and the representations made, the Taxpayer is an individual who resides in X and is in the process of obtaining a divorce. The Taxpayer sold A shares of stock in the Company, representing approximately B% of the outstanding Company shares, to the Company's ESOP for approximately $C (the "sale transaction").

The Taxpayer has made the following representations:

1. The Taxpayer made a timely election under section 1042(a) to recognize gain on the sale transaction only to the extent the amount realized on the sale transaction exceeds the Taxpayer's cost for the qualified replacement property ("QRP");

2. The taxpayer has satisfied all of the requirements of section 1042(b), including the three-year holding period of section 1042(b)(4); and

3. The Taxpayer has invested all of the proceeds from the sale transaction in QRP within the prescribed replacement period. The Taxpayer still owns the QRP.

The Taxpayer has not requested a ruling concerning the validity of the section 1042 election.

The Taxpayer filed for a divorce in L. As a part of the division of marital property, the Taxpayer would like to transfer to his spouse all or a significant percentage of the QRP.

The Taxpayer has requested the following ruling:

The transfer of the QRP from the Taxpayer to his spouse as part of a marital settlement agreement incident to their divorce will be treated as a gift under section 1042(e)(3)(C) because the transfer is treated as a gift to the spouse under section 1041(b)(1).

Section 1042(a) of the Internal Revenue Code provides that a taxpayer 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)) 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 of the Temporary Income Tax Regulations are satisfied.

Section 1042(e)(1) of the Code provides that “if a taxpayer disposes of any qualified replacement property, then, notwithstanding any other provision of this title, gain (if any) shall be recognized to the extent of the gain which was not recognized under subsection (a) by reason of the acquisition by such taxpayer of such qualified replacement property.”

The legislative history of section 1042(e) indicates that it was added as part of the Tax Reform Act of 1986 to coordinate the requirement that deferred gain be recognized on the disposition of any QRP with other nonrecognition provisions of the Code. "Effective for dispositions made after the date of enactment, the Act overrides all other provisions permitting nonrecognition and requires that gain realized upon the disposition of qualified replacement property be recognized at that time." S. Rep. 99-313, 99th Cong., 2nd Sess., 1032 (1986), 1986-3 C.B., v. 3, 1032. Limited exceptions to this rule are provided in section 1042(e)(3). Thus, gain realized from the disposition of any QRP by a taxpayer who made an election under section 1042 must be recognized at the time of the disposition regardless of any other nonrecognition provisions of the Code that may otherwise have applied.

Section 1042(e)(3) provides that the recapture rules of section 1042(e)(1) shall not apply to any transfer of qualified replacement property that occurs: 1) in any reorganization (within the meaning of section 368) unless the person making the election under section 1042(a)(1) owns stock representing control of the acquiring or acquired corporation and such property is substituted basis property in the hands of the transferee; 2) by reason of the death of the person making the election; 3) by gift, or 4) in any transaction to which section 1042(a) applies. Neither the statute nor the Temporary Income Tax Regulations define the term "gift" for purposes of section 1042(e)(3).

Section 1041(a) of the Code provides that no gain of loss is recognized on the transfer of property from an individual to (or in trust for the benefit of) (1) a spouse, or (2) a former spouse, but only if the transfer is incident to the divorce.

Section 1041(b) of the Code provides that, in the case of any transfer of property described in section 1041(a), the property shall be treated as acquired by the transferee by gift, and the basis of the transferee in the property shall be the adjusted basis of the transferor. Under section 1041(c), a transfer of property is incident to the divorce if the transfer: (1) occurs within 1 year after the date on which the marriage ceases, or (2) is related to the cessation of the marriage. In the present case, the proposed transfer of the QRP is a transaction described in section 1041(c).

Although section 1041(b) refers only to the transferee’s treatment of the transfer of property as a gift, the legislative history underlying section 1041 provides that “transfer[s] will be treated, for income tax purposes, in the same manner as a gift.” H.R. Rep. No. 432, 98th Cong., 2d Sess. 1491, 1492 (1984).

Thus, treating the transferor as having made a gift for purposes of section 1042(e)(3)(C) is consistent with section 1041 and its legislative history. Further, since the transferee is treated as receiving a gift under section 1041(b), it follows that the transferor should be treated as making a gift.

Therefore, based on the specific facts of this case and representations made by the Taxpayer, we conclude that the proposed transfer of the QRP by the Taxpayer to his spouse will be treated as a gift under section 1042(e)(3)(C) and will not cause the Taxpayer to recapture deferred gain on the QRP under section 1042(e)(1).

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the facts described above under any other provision of the Code.

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's representative and accompanied by a penalty of perjury statement executed by the Taxpayer. Since this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

Sincerely yours,

John T. Ricotta
Chief, Qualified Plans Branch 2
Office of Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures:
Copy of this letter
Copy for 6110 purposes