Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:

Telephone Number:

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Date:
May 22, 2014

Company	=
Taxpayer A	=
Taxpayer B	=
ESOP	=
X shares	=
Firm C	=
Firm D	=
Individual E	=
Amount X	=
Amount Y	=
Amount Z	=
Year 1	=
Year 2	=
Date 1	=

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Date 10 =

Dear :

This letter responds to your request, submitted on your behalf by your authorized representative, for a ruling that you have substantially complied with the requirements of section 1042 of the Internal Revenue Code (Code) and the applicable regulations in connection with a sale of stock of the Company to the employee stock ownership plan (ESOP) maintained by the Company.

The following facts and representations have been submitted under penalty of perjury in support of the ruling requested.

Taxpayers A and B are husband and wife. Their filing status for their U.S. Individual Income Tax Return is “married filing jointly.”

The Company was a domestic C corporation at the time of the sale to the ESOP, and never had any stock outstanding that was readily tradable on an established securities market. The Company established an ESOP that is intended to be qualified under section 401(a) of the Code and to meet the requirements of section 4975(e)(7).

On Date 1, Taxpayer A sold X shares of Company common stock to the ESOP for Amount X. As a result of the sale, Taxpayer A realized a gain of Amount Y. At the time of the sale, Taxpayer A had held the common stock for more than 3 years. Taxpayer A did not receive the stock in a distribution from a plan described in section 401(a) of the Code, or in a transfer pursuant to an option or other right to acquire stock to which

sections 83, 422 or 423 applied. After the transaction, the ESOP owned 99.9% of the total value of the outstanding stock of the Company, and Taxpayer A owned 0.1%.

Taxpayer A represents that he intended to defer recognition of the gain on the sale to the ESOP under section 1042 of the Code. Taxpayers A and B relied on their accounting firm, Firm C, to advise them on the requirements for making the section 1042 election, and to prepare their U.S. Individual Income Tax Return for Year 1, the year of the sale to the ESOP. Taxpayer A informed Firm C of his intention to make an election under section 1042, but Firm C failed to attach the section 1042 election statement to Taxpayer A and B's return, or to advise Taxpayers A and B that the return was incomplete without the required statements. Taxpayers A and B filed the return on Date 2. After Date 2, but before the extended due date for the return, Firm C realized its error. Thus, pursuant to section 301.9100-2 of the Procedure and Administration Regulations, on Date 3 Taxpayers A and B filed an amended U.S. Individual Income Tax Return for Year 1. The amended return included the election under section 1042 and a statement executed by the Company pursuant to section 1042(b), whereby the Company agreed to be bound by the terms of sections 4978 and 4979A.

On various dates between Date 4 and Date 5 in Year 2, Taxpayer A invested a portion of the proceeds from the sale to the ESOP in qualified replacement property, as defined in section 1042(c)(4) of the Code. The total cost of the qualified replacement property was Amount Z. One of the dates of purchase (Date 4) occurred before the section 1042 election was filed with the taxpayer's amended return on Date 3; the other purchases occurred after Date 3. Firm C did not notify the taxpayers that they were required to attach a statement of purchase for the qualified replacement property bought at the time of the section 1042 election to the election statement filed with their tax return.

Taxpayers A and B represent that they were dissatisfied with Firm C's service, in particular with Firm C's failure to attach the section 1042 election statement to their original return for Year 1. On Date 6, the taxpayers decided to retain Firm D to prepare their income tax return for Year 2. Also on Date 6, Taxpayer A informed Firm D of the election he had filed under section 1042, and of the qualified replacement property that he had purchased. Taxpayer A relied on Firm D's advice for completing the remaining requirements for the section 1042 election.

On Date 7, based on the advice of Firm D, Taxpayer A executed notarized statements of purchase for all of the qualified replacement property he had purchased. Also on Date 7, Company's Chief Financial Officer emailed the notarized statements of purchase to Individual E at Firm D.

Firm D prepared Taxpayers A and B's return for Year 2, but failed to attach the notarized statements of purchase, or to advise Taxpayers A and B that the return was incomplete without the statements of purchase. As a result, none of the statements of purchase were attached to the return that Taxpayers A and B filed on or about Date 8,

the extended due date for the return. Taxpayers A and B were unaware of this failure until Date 9, when they and Firm D were reviewing year-end tax planning strategies. After discovering the error, on Date 10 Taxpayers A and B submitted this ruling request along with an amended return for Year 2 that included the notarized statements of purchase.

You have requested a ruling that, based on the specific facts of this case, Taxpayers A and B will be treated as having substantially complied with the requirements for an election for the 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 sale satisfies the requirements of section 1042(b).

A sale of “qualified securities” meets the requirements of section 1042(b) if: (1) the qualified securities are sold to an ESOP or an eligible worker owned cooperative; (2) the plan or cooperative owns (after application of section 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).

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 sections 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) states further 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. If the taxpayer has not purchased qualified replacement property at the time of the filing of the statement of election, a timely election under this Q&A shall not be considered to have been made unless the taxpayer attaches the notarized statement of

purchase described above to the taxpayer's income tax return filed for the taxable year following the year for which the election under section 1042(a) was made.

Proposed section 1.1042-1T (Q&A-3) of the Temporary Income Tax Regulations provides that the statement of purchase must be notarized not later than the time the taxpayer files the income tax return for the taxable year in which the sale of qualified securities occurred in any case in which any qualified replacement property was purchased by such time and during the qualified replacement period. If qualified replacement property is purchased after such filing date but during the qualified replacement period, the statement of purchase must be notarized not later than the time the taxpayer's income tax return is filed for the taxable year following the year for which the election under section 1042(a) was made. The Notice of Proposed Rulemaking, issued on July 10, 2003, provides that taxpayers may rely on the proposed regulations for all open years.

Sections 301.9100-1, 301.9100-2, and 301.9100-3 of the Procedure and Administration Regulations provide the standards the Commissioner will use to determine whether to grant an extension of time to make a regulatory election. Sections 301.9100-1 and 301.9100-2 also provide an automatic extension of time to make certain statutory elections. Section 301.9100-1(b) of the regulations defines a regulatory election as an election whose due date is prescribed by a regulation published in the Federal Register or a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin. Section 301.9100-1(b) defines a statutory election as an election whose due date is prescribed by statute.

Section 301.9100-2(b) provides that an automatic extension of 6 months from the due date of a return (excluding extensions) is granted to make a statutory election whose due date is the due date of the return or the due date of the return including extensions provided that the taxpayer timely filed its return for the year the election should have been made and the taxpayer takes "corrective action" as defined in paragraph (c) of this section within the 6 month period.

Section 301.9100-2(c) provides that "corrective action" means taking the steps required to file the election in accordance with the statute or the regulation published in the Federal Register. For those elections required to be filed with a return, corrective action includes filing an original or an amended return for the year the statutory election should have been made and attaching the appropriate form for or statement for making the election. Taxpayers who make an election under an automatic extension (and all taxpayers whose tax liability would be affected by the election) must file their return in a manner that is consistent with the election and comply with all other requirements for making the election for the year the election should have been made and for all affected years; otherwise, the IRS may invalidate the election.

"Substantial compliance with regulatory requirements may suffice when such requirements are procedural and when the essential statutory purposes have been fulfilled." Young v. Commissioner, 783 F.3d 1201, 1205 (5th Cir. 1986) (quoting American Air Filter Co. v. Commissioner, 81 T.C. 709, 719 (1983)).

Filing the statement of election is an essential requirement of section 1042. *See* Estate of Clause v. Commissioner, 122 T.C. 115, 122 (2004) ("As the plain language of section 1042 indicates, the 'essence' of the statute is to demand evidence of a binding election to accept the tax consequences imposed by the section.").

With respect to the filing of Taxpayer A's election statement, because the deadline for making a section 1042 election is set by section 1042(c)(6) of the Code (as the due date, including extensions, of the taxpayer's return for the year of the sale), section 1042(a) is a statutory election. Accordingly, section 301.9100-2(b) of the Procedure and Administration Regulations provides an automatic extension of 6 months from the due date of the return for the year in which the sale to the ESOP was made in order to make a section 1042 election, provided that the taxpayers' return was timely filed for the year the election should have been made and the taxpayers take corrective action as defined in section 301.9100-2(c) within the 6-month period. In the present case, Taxpayers A and B's tax return for the year of the sale to the ESOP was filed before the due date set forth in section 1042(c)(6), and corrective action within the meaning of section 301.9100-2(c) was taken by Taxpayers A and B before 6 months from such due date.

Taxpayers A and B thus timely filed the election statement with their Year 1 return. With respect to the remaining requirements for making the section 1042 election, the taxpayers purchased qualified replacement property, within the meaning of section 1042(c)(4), with a value of Amount Z before the end of the replacement period under section 1042(c)(3). They represent that the sale to the ESOP met the requirements of section 1042(b). Taxpayers A and B relied on the advice of tax professionals, Firm C and Firm D, concerning the requirements necessary to complete the section 1042 election in a timely and correct manner. Based on the advice of Firm D, Taxpayer A executed notarized statements of purchase for the qualified replacement property and submitted the statements to Firm D. Upon discovering Firm D's failure to attach the statements to the Year 2 return, Taxpayers A and B filed an amended return for Year 2 with the statements of purchase attached and submitted this ruling request.

Therefore, based on the specific facts of this case and representations made by Taxpayers A and B, and provided that the ESOP was qualified under section 401(a) of the Code and met the requirements of section 4975(e)(7) at the time of the sale, we conclude that Taxpayers A and B have substantially complied with the requirements for an election under section 1042, and that the election will be treated as satisfying the requirements of section 1042 and 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 letter ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that this ruling 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,

John T. Ricotta
Branch Chief, Qualified Plans Branch 2 (Employee Benefits)
(Tax Exempt & Government Entities)

Enclosure
Copy for purposes of section 6110