**Internal Revenue Service**

Department of the Treasury

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Legend

Taxpayers =

Company =

ESOP =

LP =

X =

Dear :

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

On January 28, 1997, LP, a limited partnership, distributed Company stock to the Taxpayers. The Taxpayers had been limited partners in LP since September 16, 1987. LP had held the Company stock since March 1988.

You represent that the Company is a domestic corporation that had never had any stock outstanding that was readily tradable on an established securities market at the time of the sale to the ESOP. The Company maintains ESOP, which qualifies under section 401(a) and meets the requirements of section 4975(e)(7) of the Code.

On February 5, 1997, the Taxpayers sold 9,866 shares of Company Class C stock to the ESOP (the ESOP transaction). Taxpayers represent that they had held such stock for more than 3 years 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.

You represent that the sale of stock to ESOP satisfied the requirements of section 1042(b) of the Code. The Taxpayers' gain realized on the sale to the ESOP was X. After the sale, the ESOP held in excess of 60 percent of the total value of all outstanding stock of Company.

In 6 transactions within the period beginning three months before the ESOP transaction and ending twelve months after the ESOP transaction, the Taxpayers purchased securities that were intended to be qualified replacement property within the meaning of section 1042(c)(4) of the Code. Taxpayers invested the entire amount of their sale proceeds from the ESOP transaction in securities issued by domestic operating companies.

At the time that LP distributed the Company stock to Taxpayers, LP also furnished materials concerning the option of selling Company stock to ESOP and making an election under section 1042 of the Code. Taxpayers immediately submitted these materials to their professional tax advisor and, with his advice, determined to sell Company stock to ESOP and make the section 1042 election . The securities were acquired and designated as qualified replacement property, as stated above; however, a notarized statement of purchased was not obtained within 30 days of each transaction. During the preparation of Taxpayers joint U.S. Individual Income Tax Return for the taxable year 1997, Taxpayers' tax advisor retired and was replaced by a new professional tax advisor. In reviewing the Taxpayers' return, the new advisor discovered the oversight and immediately arranged for the preparation of notarized statements of purchase.

The Taxpayers timely filed their joint U.S. Individual Income Tax Return for the taxable year 1997 on or shortly before October 15, 1998 ( the extended due date for such return). On that return, the Taxpayers elected nonrecognition of gain under section 1042 of the Code with respect to the sale of securities to the ESOP and declared the securities referred to in the preceding paragraph as "qualified replacement property." Attached to the return were all of the statements required for a valid section 1042 election, i.e., a statement of election, the notarized statement of purchase with respect to the qualified replacement securities, and a verified written statement of the

Company consenting to the application of sections 4978 and 4979A of the Code.

The Taxpayers have requested a ruling that they have substantially complied with the requirements for making an election under section 1042 of the Code with respect to their sale of stock to the ESOP in 1997 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 before 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 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) 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;

(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.

The Taxpayers relied on tax professionals to advise them as to the preparation of any forms necessary to complete the section 1042 election in a timely and correct manner. Immediately upon discovering that the notarized statements of purchase were not executed in a timely manner, statements of purchase were notarized and were attached to Taxpayers' timely filed joint U.S. Individual Income Tax Return for the taxable year 1997.

Therefore, based on the specific facts of this case and representations made by the taxpayers, we conclude that the Taxpayers have substantially complied with the requirements for an election under section 1042 of the Code, and that the elections will be treated as satisfying the requirements of section 1.1042-1T of the Temporary Income Tax Regulations at Q&A-3 concerning the notarized statements of purchase with respect to qualified replacement property purchased by the Taxpayers.

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 taxpayers 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 taxpayers.

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,

James L. Brokaw
Chief, Branch 5
Office of Associate Chief Counsel
(Employee Benefits and Exempt Organizations)