

# Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[REG-121122-03]

RIN 1545-BC11

#### Notarized Statements of Purchase Under Section 1042

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** This document contains proposed amendments to the temporary regulations relating to notarized statements of purchase under section 1042 of the Internal Revenue Code of 1986. The proposed regulations would affect taxpayers making an election to defer the recognition of gain under section 1042 on the sale of stock to an employee stock ownership plan. The proposed regulations provide guidance on the notarization requirements of the temporary regulations.

**DATES:** Written and electronic comments and requests for a public hearing must be received by October 8, 2003.

**ADDRESSES:** Send submissions to: CC:PA:RU (REG-121122-03), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:RU (REG-121122-03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at <http://www.irs.gov/regs>.

**FOR FURTHER INFORMATION CONTACT:** Concerning the regulations, John T. Ricotta at (202) 622-6060 (not a toll-free number); concerning submissions or hearing requests, Sonya Cruse, (202) 622-7180 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

### Background

This document contains proposed amendments to the requirement of § 1.1042-1T, A-3(b) of the Temporary Income Tax regulations that a statement of purchase for qualified replacement property be notarized within 30 days of the date of purchase of the property (30-day notarization requirement).

The temporary regulations under section 1042 were published in TD 8073 on February 4, 1986 (EE-63-84) (51 FR 4312) as part of a package of temporary regulations addressing effective dates and other issues under the Tax Reform Act of 1984. The text of the temporary regulations also served as a notice of proposed rulemaking (EE-96-85) (51 FR 4391). A public hearing was held on June 26, 1986, concerning the proposed regulations.

### Explanation of Provisions

#### Overview

Section 1042(a) 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 employee stock ownership plan (ESOP) (as defined in section 4975(e)(7)) or eligible worker owned cooperative (as defined in section 1042(c)(2)) 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(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 which 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.

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 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 sections 4978 and 4979A (which provide for excise taxes on certain dispositions or allocations of securities acquired in a sale to which section 1042 applies) with respect to such employer or cooperative; and (4) the taxpayer's holding period with respect to the qualified securities is at least three years (determined as of the time of the sale).

The taxpayer must purchase *qualified replacement property* within the *replacement period*, which is defined in section 1042(c)(3) as the period which begins three 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)(C)) 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 1042(c)(4)(B) defines an *operating corporation* as a corporation more than 50 percent of the assets of which, at the time the security was purchased or before the close of the replacement period, were used in the active conduct of a trade or business.

Section 1.1042-1T A-3(a) of the Temporary Income Tax Regulations states that the election is to 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 A-3(b) states that the *statement of election* must provide