

Proposed Rules

Federal Register

Vol. 68, No. 132

Thursday, July 10, 2003

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

that the taxpayer elects to treat the sale of securities as a sale of qualified securities under section 1042(a) and must 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 eligible worker-owned cooperative to which the qualified securities were sold; and (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, A-3(b) 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. The purpose of the statement of purchase is to identify qualified replacement property with respect to a sale of qualified securities. The qualified replacement property will have its cost basis reduced under section 1042(d) to reflect the gain on the sale of qualified securities that is being deferred by the taxpayer. Upon subsequent disposition of the qualified replacement property by the taxpayer, the deferred gain will be recognized by the taxpayer under section 1042(e). Under section 1042(f), the filing of the statement of purchase of qualified replacement property (or a statement of the taxpayer's intention not to purchase replacement property) will begin the statutory period for assessment of any deficiency with respect to gain arising from the sale of the qualified securities. The purpose of the 30-day notarization requirement is to provide a contemporaneous identification of replacement property.

However, the 30-day notarization requirement leads to frequent mistakes by taxpayers and their advisors. Taxpayers are often unaware of this requirement and become aware of it only when they prepare their tax returns for the year of sale to the ESOP. By this

time, the 30-day period is typically past because purchases of replacement property may have been made up to one year before. A number of private letter rulings have been issued granting relief to taxpayers in these situations as long as the statements were notarized shortly after the taxpayer became aware of the requirement and it was represented that the property listed was the only replacement property purchased for this sale.

A number of commentators on the temporary and proposed regulations criticized this requirement as without statutory authority, a trap for the unwary, and inconsistent with the definition of the qualified replacement period in section 1042(c)(3).

Proposed Amendment to the Regulations

In order to facilitate taxpayer compliance with the temporary regulations concerning identification of qualified replacement property through notarization of the statements of purchase, the proposed amendment to the temporary regulations would modify § 1.1042-1T, A-3(b) to provide that the notarization requirements for the *statement of purchase* are satisfied if the taxpayer's statement of purchase is 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 was purchased after such filing date and 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.

Proposed Effective Date

The proposed amendments to the temporary regulations would apply to taxable years of sellers ending on or after the date of publication of the Treasury decision adopting these amendments as final regulations in the **Federal Register**. However, taxpayers may rely upon these proposed regulations for guidance with respect to all open taxable years pending the issuance of final regulations. If, and to the extent, future guidance is more restrictive than the guidance in these proposed regulations, the future guidance will be applied without retroactive effect.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, these proposed regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and 8 copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is John T. Ricotta of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to The Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. In § 1.1042-1T, A-3, in the undesignated paragraph following paragraph (b)(6), the penultimate

sentence is removed and three sentences added in its place to read as follows:

§ 1.1042-1T Questions and Answers relating to the sales of stock to employee stock ownership plans or certain cooperatives (temporary).

* * * * *

Q-3. * * *

A-3. * * *

(b) * * *

(6) * * *

* * * Such 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 previous two sentences apply to taxable years of sellers ending on or after [the date final regulations are published in the **Federal Register**].

* * *

* * * * *

Robert E. Wenzel,

Deputy Commissioner for Services and Enforcement.

[FR Doc. 03-17088 Filed 7-9-03; 8:45 am]

BILLING CODE 4830-01-P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

[REG-140808-02]

RIN 1545-BB16

Disclosure of Return Information by Certain Officers and Employees for Investigative Purposes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In the Rules and Regulations section of this issue of the **Federal Register**, the IRS is issuing temporary regulations relating to the disclosure of return information pursuant to section 6103(k)(6) of the Internal Revenue Code. The temporary regulations describe the circumstances under which officers or

employees of the IRS, the IRS Office of Chief Counsel, and the Office of Treasury Inspector General for Tax Administration (TIGTA), in connection with official duties relating to any examination, administrative appeal, collection activity, administrative, civil or criminal investigation, enforcement activity, ruling, negotiated agreement, profiling activity, or other proceeding or offense under the internal revenue laws or related statutes, or in preparation for any proceeding described in section 6103(h)(2) (or investigation which may result in such a proceeding), may disclose return information to the extent necessary to obtain information relating to such official duties or to accomplish properly any activity connected with such official duties. The temporary regulations amend the existing regulations to clarify and elaborate on the facts and circumstances in which disclosure pursuant to section 6103(k)(6) is authorized. The temporary regulations clarify that IRS and TIGTA officers and employees make the determination, based on the facts and circumstances, at the time of the disclosure, whether a disclosure is necessary to obtain the information sought, and that section 6103(k)(6) does not affect the authority or decision of IRS and TIGTA officers and employees to initiate, or to conduct, an investigation, or to determine the nature of the investigation. The temporary regulations clarify that the return information of any taxpayer, not only the taxpayer under investigation, may be disclosed when necessary to obtain the particular information sought. The temporary regulations clarify that section 6103(k)(6) permits IRS and TIGTA officers and employees to identify themselves, their organizational affiliation with the IRS (*e.g.*, Criminal Investigation (CI) or TIGTA (*e.g.*, Office of Investigations (OI)), and the nature of their investigation when making oral, written, or electronic contacts with third party witnesses.

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-140808-02), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:RU (REG-140808-02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet directly to

the IRS Internet site: <http://www.irs.gov/regs>.

FOR FURTHER INFORMATION CONTACT: Helene R. Newsome, 202-622-4570 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Under section 6103(a), returns and return information are confidential unless the Internal Revenue Code (Code) authorizes disclosure. Section 6103(k)(6) authorizes an internal revenue officer or employee and an officer or employee of TIGTA, in connection with official duties relating to any audit, collection activity, civil or criminal tax investigation, or offense under the internal revenue laws or related statutes, to disclose return information to a person other than the taxpayer to whom such return information relates (or his or her representative) to the extent that such disclosure is necessary to obtain information not otherwise reasonably available with respect to the correct determination of tax, liability for tax, or the amount to be collected, or with respect to the enforcement of any other provision of the Code or related statutes. Disclosure is subject to situations and conditions prescribed by regulation.

The proposed regulations amend the existing regulations to reflect a recent legislative amendment to section 6103(k)(6). The Consolidated Appropriations Act, 2001, Public Law 106-554 (114 Stat. 2763), was signed into law on December 21, 2000. Section 1 of that Act enacted into law H.R. 5662, the Community Renewal Tax Relief Act of 2000. Section 313(c) of the Community Renewal Tax Relief Act of 2000 amended section 6103(k)(6) to clarify that officers or employees of TIGTA are among those persons authorized to make disclosures under section 6103(k)(6).

The proposed regulations also clarify the standard used in determining whether disclosures are authorized under section 6103(k)(6). Recent litigation indicates that there is some confusion as to the authority of IRS (and now TIGTA) officers and employees to make disclosures in certain situations under section 6103(k)(6). The proposed regulations seek to address these issues. In particular, the proposed regulations address the issues surrounding the disclosures that occur when IRS or TIGTA officers and employees introduce themselves to third party witnesses or communicate in writing using, *e.g.*, official letterhead that reveals affiliation with IRS or TIGTA. The proposed regulations also clarify