A–18: In order to make an election under section 1041 for property transfers after December 31, 1983, or property transfers under instruments that were in effect on or before July 18, 1984, both spouses (or former spouses) must elect the application of the rules of section 1041 by attaching to the transferor's first filed income tax return for the taxable year in which the first transfer occurs, a statement signed by both spouses (or former spouses) which includes each spouse's social security number and is in substantially the form set forth at the end of this answer.

In addition, the transferor must attach a copy of such statement to his or her return for each subsequent taxable year in which a transfer is made that is governed by the transitional election. A copy of the signed statment must be kept by both parties.

The election statements shall be in substantially the following form:

In the case of an election regarding transfers after 1983:

SECTION 1041 ELECTION

The undersigned hereby elect to have the provisions of section 1041 of the Internal Revenue Code apply to all qualifying transfers of property after December 31, 1983. The undersigned understand that section 1041 applies to all property transferred between spouses, or former spouses incident to divorce. The parties further understand that the effects for Federal income tax purposes of having section 1041 apply are that (1) no gain or loss is recognized by the transferor spouse or former spouse as a result of this transfer; and (2) the basis of the transferred property in the hands of the transferee is the adjusted basis of the property in the hands of the transferor immediately before the transfer, whether or not the adjusted basis of the transferred property is less than, equal to, or greater than its fair market value at the time of the transfer. The undersigned understand that if the transferee spouse or former spouse disposes of the property in a transaction in which gain is recognized, the amount of gain which is taxable may be larger than it would have been if this election had not been made.

In the case of an election regarding preexisting decrees:

SECTION 1041 ELECTION

The undersigned hereby elect to have the provisions of section 1041 of the Internal Revenue Code apply to all qualifying transfers of property after July 18, 1984 under any instrument in effect on or before July 18, 1984. The undersigned understand that section 1041 applies to all property transferred between spouses, or former spouses incident to the divorce. The parties further understand that the effects for Federal income tax purposes of having section 1041 apply are that (1) no gain or loss is recognized by the transferor spouse or former spouse as a result of this transfer; and (2) the basis of the transferred property in the hands of the transferee is the adjusted basis of the property in the hands of the transferor immediately before the transfer, whether or not the adjusted basis of the transferred property is less than, equal to, or greater than its fair market value at the time of the transfer. The undersigned understand that if the transferee spouse or former spouse disposes of the property in a transaction in which gain is recognized, the amount of gain which is taxable may be larger than it would have been if this election had not been made.

(Secs. 1041(d)(4), (98 Stat. 798, 26 U.S.C. 1041(d)(4)), 152(e)(2)(A) (98 Stat. 802, 26 U.S.C. 152(e)(2)(A)), 215(c) (98 Stat. 800, 26 U.S.C. 215(c)) and 7805 (68A Stat. 917, 26 U.S.C. 7805) of the Internal Revenue Code of 1954))

[T.D. 7973, 49 FR 34452, Aug. 31, 1984]

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

Q–1: What does section 1042 provide?

A–1: (a) Section 1042 provides rules under which a taxpayer may elect not to recognize gain in certain cases where *qualified securities* are sold to a qualifying employee stock ownership plan or worker-owned cooperative in taxable years of the seller beginning after July 18, 1984, and *qualified replacement property* is purchased by the taxpayer within the *replacement period*. If the requirements of Q&A–2 of this section are met, and if the taxpayer makes an election under section 1042(a) in accordance with Q&A–3 of this section, the gain realized by the taxpayer on the sale of the qualified securities is recognized only to the extent that the amount realized on such sale exceeds the cost to the taxpayer of the qualified replacement property.

(b) Under section 1042, the term *qualified securities* means employer securities (as defined in section 409(l)) with respect to which each of the following

requirements is satisfied: (1) The employer securities were issued by a domestic corporation; (2) for at least one year before and immediately after the sale, the domestic corporation that issued the employer securities (and each corporation that is a member of a *controlled group of corporations* with such corporation for purposes of section 409(l)) has no stock outstanding that is readily tradeable on an established market; (3) as of the time of the sale, the employer securities have been held by the taxpayer for more than 1 year; and (4) the employer securities 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, 422A, 423, or 424 applies.

(c) The term *replacement period* means the period which begins 3 months before the date on which the sale of qualified securities occurs and which ends 12 months after the date of such sale. A replacement period may include any period which occurs prior to July 19, 1984.

(d) The term *qualified replacement property* means any securities (as defined in section 165(g)(2)) issued by a domestic corporation which does not, for the taxable year of such corporation in which the securities are purchased by the taxpayer, have passive investment income (as defined in section 1362(d)(3)(D)) that exceeds 25 percent of the gross receipts of such corporation for the taxable year preceding the taxable year of purchase. In addition, securities of the domestic corporation that issued the employer securities qualifying under section 1042 (and of any corporation that is a member of a *controlled group of corporations* with such corporation for purposes of section 409(l)) will not qualify as *qualified replacement property*.

(e) For purposes of section 1042(a), there is a *purchase* of qualified replacement property only if the basis of such property is determined by reference to its cost to the taxpayer. If the basis of the qualified replacement property is determined by reference to its basis in the hands of the transferor thereof or another person, or by reference to the basis of property (other than cash or its equivalent) exchanged for such property, then the basis of such property is not determined solely by reference to its cost to the taxpayer.

Q–2: What is a sale of qualified securities for purposes of section 1042(b)?

A–2: (a) Under section 1042(b), a sale of qualified securities is one under which all of the following requirements are met:

(1) The qualified securities are sold to an employee stock ownership plan (as defined in section 4975(e)(7)) maintained by the corporation that issued the qualified securities (or by a member of the *controlled group of corporations* with such corporation for purposes of section 409(l)) or to an eligible worker-owned cooperative (as defined in section 1042(c)(2));

(2) The employee stock ownership plan or eligible worker-owned cooperative owns, immediately after the sale, 30 percent or more of the total value of the employer securities (within the meaning of section 409(l) outstanding as of such time;

(3) No portion of the assets of the employee stock ownership plan or eligible worker-owned cooperative attributable to qualified securities that are sold to the plan or cooperative by the taxpayer or by any other person in a sale with respect to which an election under section 1042(a) is made accrue under the plan or are allocated by the cooperative, either directly or indirectly and either concurrently with or at any time thereafter, for the benefit of (i) the taxpayer; (ii) any person who is a member of the family of the taxpayer (within the meaning of section 267(c)(4)); or (iii) any person who owns (after the application of section 318(a)), at any time after July 18, 1984, and until immediately after the sale, more than 25 percent of in value of the outstanding portion of any class of stock of the corporation that issued the qualified securities (or of any member of the *controlled group of corporations* with such corporation for purposes of section 409(l)). For purposes of this calculation, stock that is owned, directly or indirectly, by or for a qualified plan shall not be treated as outstanding.

(4) The taxpayer files with the Secretary (as part of the required election described in Q&A–3 of this section) a

verified written statement of the domestic corporation (or corporations) whose employees are covered by the plan acquiring the qualified securities or of any authorized officer of the eligible workerowned cooperative, consenting to the application of section 4978(a) with respect to such corporation or cooperative.

(b) For purposes of determining whether paragraph (a)(2) of this section is satisfied, sales of qualified securities by two or more taxpayers may be treated as a single sale if such sales are made as part of a single, integrated transaction under a prearranged agreement between the taxpayers.

(c) For purposes of determining whether paragraph (a)(3) of this section is satisfied with respect to the prohibition against an accrual or allocation of qualified securities, the accrual or allocation of any benefits or contributions or other assets that are not attributable to qualified securities sold to the employee stock ownership plan or eligible worker-owned cooperative in a sale with respect to which an election under section 1042(a) is made (including any accrual or allocation under any other plan or arrangement maintained by the corporation or any member of *the controlled group of corporations* with such corporation for purposes of section 409(l)) must be made without regard to the allocation of such qualified securities. Paragraph (a)(3) of this section above may be illustrated in part by the following example: Individuals A, B, and C own 50, 25, and 25, respectively, of the 100 outstanding shares of common stock of Corporation X. Such shares constitute qualified securities as defined in Q&A–1 of this section. A and B, but not C, are employees of Corporation X. For the benefit of all its employees, Corporation X establishes an employee stock ownership plan that obtains a loan meeting the exemption requirements of section 4975(d)(3). The loan proceeds are used by the plan to purchase the 100 shares of qualified securities from A, B, and C, all of whom elect nonrecognition treatment under section 1042(a) with respect to the gain realized on their sale of such securities. Under the requirements of paragraph (a)(3) of this section, no part of the assets of the plan attributable to the 100 shares of qualified securities may accrue under the plan (or under any other plan or arrangement maintained by Corporation X) for the benefit of A or B or any person who is a member of the family of A or B (as determined under section 267(c)(4)). Furthermore, no other assets of the plan or assets of the employer may accrue for the benefit of such individuals in lieu of the receipt of assets attributable to such qualified securities.

(d) A sale under section 1042(a) shall not include any sale of securities by a dealer or underwriter in the ordinary course of its trade or business as a dealer or underwriter, whether or not guaranteed.

Q–3: What is the time and manner for making the election under section 1042(a)?

A–3: (a) The election not to recognize the gain realized upon the sale of qualified securities to the extent provided under section 1042(a) 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. If a taxpayer does not make a timely election under this section to obtain section 1042(a) nonrecognition treatment with respect to the sale of qualified securities, it may not subsequently make an election on an amended return or otherwise. Also, an election once made is irrevocable.

(b) 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 employee stock ownership plan 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. See Q&A–2 of this section.

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 the qualified replacement property with respect to the sale of qualified securities. Such statement of purchase must be notarized by the later of thirty days after the purchase or March 6, 1986. In addition, the statement of election must be accompanied by the verified written statement of consent required under Q&A–2 of this section with respect to the qualified securities sold.

(c) 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. Such notarized statement of purchase shall be filed with the district director or the director of the regional service center with whom such election was originally filed, if the return is not filed with such director.

Q–4: What is the basis of qualified replacement property?

A–4: If a taxpayer makes an election under section 1042(a), the basis of the qualified replacement property purchased by the taxpayer during the replacement period shall be reduced by an amount equal to the amount of gain which was not recognized. If more than one item of qualified replacement property is purchased, the basis of each of such items shall be reduced by an amount determined by multiplying the total gain not recognized by reason of the application of section 1042(a) by a fraction, the numerator of which is the cost of such item of property and the denominator of which is the total cost of all such items of property. For the rule regarding the holding period of qualified replacement property, see section 1223(13).

Q–5: What is the statute of limitations for the assessment of a deficiency relating to the gain on the sale of qualified securities?

A–5: (a) If any gain is realized by the taxpayer on the sale of any qualified securities and such gain has not been recognized under section 1042(a) in accordance with the requirements of this section, the statutory period provided in section 6501(a) for the assessment of any deficiency with respect to such gain shall not expire prior to the expiration of 3 years from the date of receipt, by the district director or director of regional service center with whom the statement of election under 1042(a) was originally filed, of:

(1) A notarized statement of purchase as described in Q&A–3;

(2) A written statement of the taxpayer's intention not to purchase qualified replacement property within the replacement period; or

(3) A written statement of the taxpayer's failure to purchase qualified replacement property within the replacement period.

In those situations when a taxpayer is providing a written statement of an intention not to purchase or of a failure to purchase qualified replacement property, the statement shall be accompanied, where appropriate, by an amended return for the taxable year in which the gain from the sale of the qualified securities was realized, in order to reflect the inclusion in gross income for that year of gain required to be recognized in connection with such sale.

(b) Any gain from the sale of qualified securities which is required to be recognized due to a failure to meet the requirements under section 1042 shall be included in the gross income for the taxable year in which the gain was realized. If any gain from the sale of qualified securities is not recognized under section 1042(a) in accordance with the requirements of this section,

any deficiency attributable to any portion of such gain may be assessed at any time before the expiration of the 3-year period described in this Q&A, notwithstanding the provision of any law or rule of law which would otherwise prevent such assessment.

Q–6: When does section 1042 become effective?

A–6: Section 1042 applies to sales of qualified securities in taxable years of sellers beginning after July 18, 1984.

[T.D. 8073, 51 FR 4333, Feb. 4, 1986]

§ 1.1044(a)–1 Time and manner for making election under the Omnibus Budget Reconciliation Act of 1993.

(a) *Description.* Section 1044(a), as added by section 13114 of the Omnibus Budget Reconciliation Act of 1993 (Pub. L. 103–66, 107 Stat. 430), generally allows individuals and C corporations that sell publicly traded securities after August 9, 1993, to elect not to recognize certain gain from the sale if the taxpayer purchases common stock or a partnership interest in a specialized small business investment company (SSBIC) within the 60-day period beginning on the date the publicly traded securities are sold.

(b) *Time and manner for making the election.* The election under section 1044(a) must be made on or before the due date (including extensions) for the income tax return for the year in which the publicly traded securities are sold. The election is to be made by reporting the entire gain from the sale of publicly traded securities on Schedule D of the income tax return in accordance with instructions for Schedule D, and by attaching a statement to Schedule D showing—

(1) How the nonrecognized gain was calculated;

(2) The SSBIC in which common stock or a partnership interest was purchased;

(3) The date the SSBIC stock or partnership interest was purchased; and

(4) The basis of the SSBIC stock or partnership interest.

(c) *Revocability of election.* The election described in this section is revocable with the consent of the Commissioner.

(d) *Effective date.* The rules set forth in this section are effective December 12, 1996.

[T.D. 8688, 61 FR 65322, Dec. 12, 1996]

SPECIAL RULES

§ 1.1051–1 Basis of property acquired during affiliation.

(a)(1) The basis of property acquired by a corporation during a period of affiliation from a corporation with which it was affiliated shall be the same as it would be in the hands of the corporation from which acquired. This rule is applicable if the basis of the property is material in determining tax liability for any year, whether a separate return or a consolidated return is made in respect of such year. For the purpose of this section, the term *period of affiliation* means the period during which such corporations were affiliated (determined in accordance with the law applicable thereto), but does not include any taxable year beginning on or after January 1, 1922, unless a consolidated return was made, nor any taxable year after the taxable year 1928.

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following example:

Example: The X Corporation, the Y Corporation, and the Z Corporation were affiliated for the taxable year 1920. During that year the X Corporation transferred assets to the Y Corporation for $120,000 cash, and the Y Corporation in turn transferred the assets during the same year to the Z Corporation for $130,000 cash. The assets were acquired by the X Corporation in 1916 at a cost of $100,000. The basis of the assets in the hands of the Z Corporation is $100,000.

(b) The basis of property acquired by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return was made or was required under the regulations governing the making of consolidated returns, shall be determined in accordance with such regulations. The basis in the case of property held by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return is