

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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TY:

Legend

- Taxpayer =
- Year 1 =
- Corporation =
- Z =
- Accounting Firm 1 =
- Date 1 =
- Date 2 =
- Date 3 =
- Accounting Firm 2 =
- Accountant 1 =

Dear :

This letter is in reference to your letter dated . In your letter, you requested an extension of time on behalf of Taxpayer to make a late election to treat dividends as investment income under section 163(d) of the Internal Revenue Code. The request to make the late election is based on sections 301.9100-1 and -3 of the Procedure and Administration Regulations.

FACTS

In Year 1, Taxpayer was the chief executive officer and controlling shareholder of Corporation. On Date 1, Corporation formally issued Taxpayer shares of the common stock of Corporation. In Year 1, Corporation redeemed some of Taxpayer's stock for Z.

Taxpayer's original Year 1 tax return was prepared by Accounting Firm 1 and was filed under extension on Date 2. Soon thereafter, on Date 3, Taxpayer called Accounting Firm 1 and informed them that he had unreported stock sales for Year 1. Accounting Firm 1 and Taxpayer agreed to file an amended return when Taxpayer

received the final documents relating to another transaction in that tax year. Accounting Firm 1 was aware that Accounting Firm 2 prepared Corporation's tax return for Year 1. Accounting Firm 1 assumed that Accounting Firm 2 discussed the stock redemption with Taxpayer. The amended return reported the stock redemption as long term capital gain. Taxpayer relied upon Accounting Firm 1 and Accounting Firm 2 to complete and timely file his Form 1040. Taxpayer had employed Accounting Firm 1 for many years prior to Year 1. Accounting Firm 2 did not explain how to report the redemption to either Taxpayer or Accounting Firm 1. Accounting Firm 1 neglected to report the redemption at all on Taxpayer's return for Year 1.

The amended 1040 return for Year 1 was audited and it was determined that the stock redemption did not qualify for capital gains treatment, but was essentially equivalent to a dividend. Taxpayer retained a new tax advisor, Accountant 1, to advise him. Accountant 1 determined that Accounting Firm 1 had failed to elect to treat a portion of the stock redemption proceeds as investment income on a timely filed Form 4952.

LAW & ANALYSIS

Section 163(d)(1) provides that, in the case of a taxpayer other than a corporation, the amount allowed as a deduction for investment interest shall not exceed the net investment income of the taxpayer for the taxable year. Investment interest expense that is disallowed by section 163(d)(1) may be carried to the next taxable year. section 163(d)(2).

Section 163(d)(4)(B) provides, in part, that investment income is the sum of –
(i) gross income from property held for investment (other than gain taken into account under clause (ii)(I),
(ii) the excess (if any) of
(I) the net gain attributable to the disposition of property held for investment, over
(II) the net capital gain determined by only taking into account gains and losses from dispositions of property held for investment, plus
(III) so much of the net capital gain referred to in clause (ii)(I) as the taxpayer elects to take into account under such clause.

Section 163(d)(4)(B) also states that such term shall include qualified dividend income (as defined in section (1)(h)(ii)(B)) only to the extent the taxpayer elects to treat such income as investment income for purposes of this subsection.

Section 1.163(d)-1T(b) of the Income Tax Regulations provides that the election under section 163(d)(4)(B) must be made on or before the due date (including extensions) of the income tax return for the taxable year in which the qualified dividend income is received.

Under section 301.9100-1(c), the Commissioner has discretion to grant a reasonable extension of time to make a regulatory election under all subtitles of the Code, except subtitles E, G, H and I, provided that the taxpayer acted reasonably and in good faith and granting relief will not prejudice the interests of the government. For this purpose, section 301.9100-1(b) defines the term 'regulatory election' to include an election whose deadline is prescribed by a revenue ruling, revenue procedure, notice or announcement published in the Internal Revenue Bulletin.

Section 301.9100-3 provides extensions of time to make a regulatory election under Code sections other than those for which section 301.9100-2 expressly permits automatic extensions. Requests for extensions of time for regulatory elections will be granted when the taxpayer provides evidence (including affidavits described in the regulations) to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith and granting relief will not prejudice the interests of the government.

Section 301.9100-3(b)(1) states that a taxpayer will be deemed to have acted reasonably and in good faith if the taxpayer –

- (i) requests relief before the failure to make the regulatory election is discovered by the Service;
- (ii) inadvertently failed to make the election because of intervening events beyond the taxpayer's control;
- (iii) failed to make the election because, after exercising due diligence, the taxpayer was unaware of the necessity for the election;
- (iv) reasonably relied on the written advice of the Service; or
- (v) reasonably relied on a qualified tax professional, and the tax professional failed to make, or advise the taxpayer to make, the election.

The affidavits presented show that Taxpayer acted reasonably and in good faith, having reasonably relied upon Accounting Firm 1 and Accounting Firm 2, qualified tax accounting firms who both failed to make, or to advise the taxpayer to make, the election. Furthermore, the affidavits show that, after exercising due diligence, Taxpayer was unaware of the necessity for the election.

Under section 301.9100-3(b)(3), a taxpayer will not be considered to have acted reasonably and in good faith if the taxpayer –

- (i) seeks to alter a return position for which an accuracy related penalty has been or could be imposed under section 6662 at the taxpayer requests relief (taking into account section 1.666402(c)(3)) and the new position requires a regulatory election for which relief is requested;
- (ii) was informed in all material respects of the required election and related tax consequences, but chose not to file the election; or

(iii) uses hindsight in requesting relief. If specific facts have changed since the original deadline that make the election advantageous to a taxpayer, the Service will not ordinarily grant relief.

Taxpayer is not seeking to alter a return position for which an accuracy-related penalty has been or could be imposed under section 6662 at the time relief is requested. Taxpayer was not informed of all material respects of the election and its tax consequences. Furthermore, Taxpayer is not using hindsight in requesting relief. Taxpayer has represented that specific facts have not changed since the original deadline that made the election advantageous.

Section 301.9100-3(c)(1)(i) provides, in part, that the interests of the government are prejudiced if granting relief would result in the taxpayer having a lower tax liability in the aggregate for all taxable years affected by the election than the taxpayer would have had if the election had been timely made (taking into account the time value of money). Section 301.9100-3(c)(1)(ii) provides, in part, that the interests of the government are ordinarily prejudiced if the taxable year in which the regulatory election should have been made, or any taxable years that would have been affected by the election had it been timely made, are closed by the period of limitations on assessment. Under these criteria, the interests of the government are not prejudiced in this case. The taxpayer has represented that granting relief would not result in a lower tax liability in the aggregate for all taxable years affected by the election than the taxpayer would have had if the election had been timely made (taking into account the time value of money). Furthermore, the taxable year in which the regulatory election should have been made and any taxable years that would have been affected had it been timely made, are not closed by the period of assessment.

Accordingly, the consent of the Commissioner is hereby granted for an extension of time to file the forms necessary to make the election pursuant to section 301.9100-1 and -3 for the taxpayer under section 163(d)(4)(B). The taxpayer has an extension of 60 days from date of this ruling in which to make this election.

This ruling is directed only to the taxpayer 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 your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

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,

Christopher F. Kane
Branch Chief, Branch 3
(Income Tax & Accounting)

cc: