

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:
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TY:

Legend

Taxpayer	=
Year 1	=
Year 2	=
Year 3	=
Amount a	=
b	=
Amount c	=

Dear :

This is in response to your letter dated September 17, 2009. In your letter you requested an extension of time to make a late election to treat capital gains as investment income under sections 163(d)(1) and 163(d)(4)(B) of the Internal Revenue Code for Year 3. Additionally, you requested a revocation under section 1.163(d)-(1)(c) of the Income Tax Regulations of the election previously made to treat capital gains as investment income under section 163(d)(1) for Year 3. The request to make the late election is based on sections 301.9100-1 and 301.9100-3 of the regulations.

FACTS

Taxpayer timely filed Form 1040, Individual Income Tax Return, for Year 3. Taxpayer's return included Form 4952, Investment Interest Expense Deduction. Taxpayer identified Amount a as net capital gain from the sale of Taxpayer's interest in

b. Pursuant to the Form 4952, Taxpayer elected to treat Amount c of the net capital gain as investment income. Amount c equaled the entire amount of Taxpayer's Year 3 investment interest expense. Taxpayer represents that he intended to, and did elect to convert enough of the Year 3 net capital gain to investment income to allow a deduction for the full amount of investment interest expense for Year 3.¹

The Service audited Taxpayer's income tax returns for Year 1, Year 2, and Year 3. As a result of that audit, Taxpayer suspended certain investment interest deductions, taken during Year 1 and Year 2, under the "at risk" rules. As a result, Taxpayer will have additional investment interest expenses for Year 3 and the amount of investment income converted from net capital gain originally is now insufficient to allow deduction of these additional expenses.

Taxpayer seeks to modify the dollar amount of his election to treat net capital gain as investment interest expense for the Year 3 taxable year. Taxpayer wishes to increase the amount of his election so that he may use so much of Amount a as necessary as investment income to allow deduction of all of the investment interest in Year 3, which have increased in amount due to the exam and resulting settlement agreement with the Service.

Applicable Law

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 for any taxable year shall not exceed the net investment income of the taxpayer for the taxable year.

Section 163(d)(4)(B) provides, in pertinent part, that investment income means that sum of—

- (i) gross income from property held for investment (other than any 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 solely by 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)(II) (or, if lesser, the net gain referred to in (ii)(1)) as the taxpayer elects to take into account under this clause.

Section 1.163(d)-1(b) of the regulations provides that the election under section 163(d)(4)(B)(iii) must be made on or before the due date (including extensions) of the income tax return for the taxable year in which the net capital gain is recognized.

¹ Investment interest expense is generally deductible only up to the amount of an individual taxpayer's investment income, if any, for the same taxable year. Section 163(d)(1).

Section 1.163(d)-1(c) of the regulations provides that the election under section 163(d)(4)(B)(iii) is revocable with the consent of the Commissioner.

Sections 301.9100-1 through 301.9100-3 of the regulations provide the standards the Commissioner uses to determine whether to grant an extension of time to make a regulatory election. Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides extensions of time for making elections that do not meet the requirements of section 301.9100-2.

Section 301.9100-1(b) of the regulations defines the term “regulatory election” as an election whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, revenue procedure, notice or announcement published in the Internal Revenue Bulletin.

Section 301.9100-1(c) of the regulations provides that the Commissioner may grant a reasonable extension of time to make a regulatory election, or a statutory election (but no more than six months except in the case of a taxpayer who is abroad), under all subtitles of the Internal Revenue Code except subtitles E, G, H, and I.

Section 301.9100-3(a) of the regulations provides that requests for extensions of time for regulatory elections (other than automatic changes covered under section 301.9100-2) will be granted when the taxpayer provides evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the Government.

Section 301.9100-3(b)(1) of the regulations provides 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.

Section 301.9100-3(b)(3) of the regulations provides that 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 could be imposed under section 6662 at the time the taxpayer requests relief and the new position requires a regulatory election for which relief is requested;

- (ii) was fully informed 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.

Section 301.9100-3(c)(1) of the regulations provides that the Commissioner will grant a reasonable extension of time only when the interests of the Government will not be prejudiced by the granting of relief. Under paragraph (c)(1)(i), the interests of the government are prejudiced if granting relief would result in a 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.

Conclusion

Taxpayer's election is a regulatory election, as defined under section 301.9100-1(b), because the due date of the election is prescribed in regulation section 1.163(d)-1(b). In this situation, the requirements of sections 301.9100-1 and 301.9100-3 have been satisfied. The information and representations made by the Taxpayer establish that Taxpayer acted reasonably and in good faith. In fact, this situation is the result of the Service's examination of Taxpayer's income tax returns for Years 1-3 and the resulting postponement by Taxpayer of certain investment interest expense deductions, which were originally claimed in Year 1 and Year 2, until Year 3. As a result, Taxpayer's Year 3 investment expense deduction is now larger than it was when the Year 3 income tax return was filed. Taxpayer now has reason to elect to convert more of the Year 3, Amount a net capital gain to investment income. Finally, granting an extension will not prejudice the interests of the Government. Taxpayer has represented that Taxpayer will not have a lower tax liability in the aggregate for all taxable years affected by the election if given permission to make the election in the appropriate amount at this time than Taxpayer would have if the election were made in the appropriate amount by the original deadline for making the election.

Accordingly, Taxpayer is granted permission to revoke the amount of Taxpayer's first election to treat net gain from the disposition of investment property as investment income for Year 3. Taxpayer is further granted permission to make a late election to treat net gain from the disposition of investment property as investment income for Year 3. This extension of time is granted until 60 days following the date of this ruling.

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.

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)