

Internal Revenue Service

Department of the Treasury
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Legend

Taxpayers =
Year 1 =
Year 2 =
Year 3 =

Dear

This is in response to your letter dated September 29, 2009. In your letter you requested permission to revoke an election under section 1.163-(d)-1(c) of the Income Tax Regulations 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.

FACTS

Taxpayers timely filed a joint Form 1040, Individual Income Tax Return, for Year 3. The return was prepared and reviewed by tax professionals. Taxpayers' return included Form 4952, Investment Interest Expense Deduction, on which they elected to treat all net capital gains attributable to the sale of real property as investment income.

The Service audited Taxpayers' income tax returns for Year 1, Year 2, and Year 3. As a result of that audit, the Service determined that the real property in question was not investment property within the meaning of section 163(d)(5). As a result, Taxpayers were not entitled to deduct any investment expenses incurred in connection with this real property. Additionally, Taxpayers had no reason to elect to treat their net capital gains as investment income, which is taxed at ordinary income rates instead of capital gains rates. Accordingly, Taxpayers seek permission to revoke the election.

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.

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.

Taxpayers are requesting permission to revoke the election, which was based on tax advice rendered by tax professionals. This situation is analogous to those situations concerning taxpayers who have not made a particular election provided in the regulations because of inadequate or incorrect advice from knowledgeable tax professionals and are subsequently seeking extensions of time under section 9100 of the regulations. Rev. Rul. 83-74, 1983-1 C.B. 112.

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 Taxpayers establish that Taxpayers acted reasonably and in good faith. In fact, this situation is the result of the Service's examination of Taxpayers' income tax returns for Years 1-3 and the resulting disallowance of certain investment interest expense deductions. Finally, granting an extension will not prejudice the interests of the Government. Taxpayers have represented that Taxpayers 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 Taxpayers would have if the election were made in the appropriate amount by the original deadline for making the election.

Accordingly, the consent of the Commissioner is hereby granted for Taxpayers to revoke their election to treat net capital gain from the sale of the real property in question as investment income that they made on their Year 3 federal income tax return. The extension of time to revoke this election shall be for a period of 60 days from the date of this ruling. Taxpayers should enclose a copy of this letter with their amended return for Year 3.

This ruling is directed only to the taxpayers 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 ruling contained in this letter is based upon information and representations submitted by the taxpayers and accompanied by a penalty of perjury statement executed by appropriate parties. 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: