**Internal Revenue Service**

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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TY:

Legend

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|---|---|
| Taxpayer | = |
| Year 1 | = |
| Year 2 | = |
| Accounting Firm | = |
| Year 3 | = |

Dear :

This is response to a letter dated . You requested an extension of time to elect to revoke an election to treat qualified dividends and capital gains as investment income under sections 163(d)(1) and 163(d)(4)(B) of the Internal Revenue Code for Year 1 and section 1.163(d)-(1)(c) of the Income Tax Regulations. The request to elect to revoke the election is based on sections 301.9100-1 and -3 of the Procedure and Administration Regulations.

FACTS

Taxpayer's main source of income is investment income and income from various real estate flow-through entities. Taxpayer timely filed Form 1040, Individual Income Tax Return, for Year 1. The return was prepared using computerized tax return preparation software. Taxpayer's Year 1 return included Form 4952, Investment Interest Expense Deduction, on which they elected to treat all net long-term capital gain and qualified dividends as investment income. The effect of electing to treat qualified dividends and net capital gains as investment income is to tax the qualified dividends and net capitals gains at ordinary income tax rates. In prior years, Taxpayer had consistently elected on Form 4952 to include all qualified dividends and net capital gain in investment income.

The majority of investment interest expense reported on Form 4952 was passed through from a flow-through entity owned by Taxpayer. The interest expense reported on the associated partnership Schedule K-1 was interest expense allocated to debt-financed distributions. It is represented that the related interest expense was properly reported as investment interest expense on the Year 1 Form 1040. Also, a tracing analysis determined that Taxpayer deposited the debt-financed partnership distributions into Taxpayer's brokerage account, which generated interest and dividend income, as well as capital gains.

The original Schedule K-1 was prepared by Accounting Firm and there was an inadvertent error made with respect to the calculation of interest expense associated with debt-financed distribution interest. In Year 3, Taxpayer received an amended Form 1065, Schedule K-1 for Year 1, which reported significantly less investment interest expense allocated to Taxpayer. This amended Schedule K-1 reclassified investment interest expense to interest expense directly related to the rental trade or business. Once the amended Schedule K-1 was received, it became apparent that the election under section 163(d)(4)(B)(iii) on the Year 1 return would no longer be necessary to maximize the investment interest expense deduction.

Taxpayer made the election under section 163(d)(4)(B)(iii) based on the information available at the time the Year 1 return was prepared. Taxpayer had no control over the amendment of the Schedule K-1, and could not have known that the Year 1 Schedule K-1 was erroneous, or that there would be a change to the K-1 subsequent to the filing of the Year 1 return. The Schedule K-1 from this partnership had never been amended in the past, and Taxpayer had no reason to believe that an amended Schedule K-1 would be forthcoming.

It is represented that Taxpayer relied on Accounting Firm to accurately prepare the partnership return and was not aware of the inadvertent error at the time the Year 1 return was filed. It is further represented that it was only when the Year 2 partnership return was prepared, that the error was discovered. As a result, Taxpayer seeks permission to revoke the election.

## 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)-1(b) of the 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 or 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.

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.

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 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.

Taxpayer acted reasonably and in good faith because Taxpayer's failure to make a timely election was due to intervening events that were beyond Taxpayer's control. These intervening events include the amendment of the Year 1 Schedule K-1.

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 time the taxpayer requests relief (taking into account section 1.6664-02(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. Because of the incorrect Year 1 Schedule K-1 Taxpayer received, Taxpayer had not been informed in 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. 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 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.

## RULING

Accordingly, the consent of the Commissioner is hereby granted for an extension of time pursuant to sections 301.9100-1 and -3 for Taxpayer to revoke the prior Year 1 election pursuant to section 163(d)(4)(B) and section 1.163(d)-1(c) of the regulations. Taxpayer has an extension of 60 days from the date of this ruling in which to make this election.

This ruling is limited to providing an extension of time to elect to revoke the election under section 163(d)(4)(B). It does not provide relief from any liability incurred as a result of filing a late election; nor is it a ruling that the taxpayer is otherwise eligible to make the election. No opinion is expressed as to the applicability of any other provision of the Code or the regulations which may be applicable under these facts.

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)