

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact:

Telephone Number:

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Date:  
September 17, 2012

TY:

Legend

Taxpayers =  
Year 1 =  
Month 1 =  
Taxpayers' Representative =

Dear :

This is in response to your letter dated June 6, 2012. You requested an extension of time to elect to revoke an election to treat qualified dividends and capital gains as investment income for Year 1 under sections 163(d)(1) and 163(d)(4)(B) of the Internal Revenue Code and section 1.163(d)-(1)(c) of the Income Tax Regulations.

FACTS

Taxpayers' main source of income is investment income and rental income related to their real estate interests. Taxpayers timely filed Form 1040, Individual Income Tax Return, for Year 1. Taxpayers' Representative prepared the return using computerized tax return preparation software. Taxpayers' 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. Taxpayers paid both regular income and alternative minimum tax in Year 1.

The computerized tax return preparation software did not consider the effect of the alternative minimum tax in analyzing whether or not Taxpayers should make the election under sections 163(d)(1) and 163(d)(4)(B) in Year 1. The election increased

the total tax due because the alternative minimum tax due increased by more than the regular income tax due decreased.

Year 1 was the first year that Taxpayers' Representative prepared Taxpayers' return due to their relocation from out-of-state. Taxpayers' Representative utilized tax preparation software different from the one that had been used to prepare Taxpayers' returns prior to Year 1 by Taxpayers' previous tax preparer. Taxpayers' Representative was unaware that the software's calculation optimizes the amount of net long-term capital gain and qualified dividends to include in investment income for regular tax purposes but does not consider the effect of such an election on the alternative minimum tax.

Taxpayers represented that they relied on Taxpayers' Representative to accurately prepare Taxpayers' return and made the election under section 163(d)(4)(B)(iii) based on Taxpayers' Representative's advice. Taxpayers represented that they were unaware of the inadvertent error due to the complexity of the issue.

Taxpayers' Representative did not realize until Month 1 when Taxpayers' Representative reviewed the return for Year 1 at the request of Taxpayers' financial advisors that the Taxpayers would have been subject to less total tax in Year 1 if the election had not been made. Taxpayers' Representative contacted the software developer and was told that considering the election's effect on the alternative minimum tax was beyond the tax return preparation software's built-in capabilities. As a result, Taxpayers seek permission to revoke the election for Year 1.

## 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.

Taxpayers acted reasonably and in good faith because Taxpayers reasonably relied on a qualified tax professional who used faulty computerized tax preparation software and consequently advised Taxpayers to make the election. This software failed to consider the effect of the alternative minimum tax in analyzing whether or not Taxpayers should make the election under sections 163(d)(1) and 163(d)(4)(B) in Year 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.

Taxpayers are 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 failure of the computerized tax return preparation software to consider the alternative minimum tax in analyzing whether or not Taxpayers should elect to treat all net long-term capital gain and qualified dividends as investment income in Year 1, Taxpayers had not been informed in all material respects of the election and its tax consequences. Furthermore, Taxpayers are not using hindsight in requesting relief. Taxpayers have represented that specific facts have not changed since the original deadline that made the election appear 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. Taxpayers have represented that granting relief would not result in a lower tax liability in the aggregate for all taxable years affected by the election than Taxpayers would have had if the election had been timely made (taking into account the time value of money). Furthermore, the taxable years 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 Taxpayers to revoke the prior Year 1 election pursuant to section 163(d)(4)(B) and section 1.163(d)-1(c) of the regulations.

Taxpayers have an extension of 60 days from the date of this ruling in which revoke the election for Year 1 by filing an amended return for that year.

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  
Chief, Branch 3  
(Income Tax & Accounting)