Internal Revenue Service

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Department of the Treasury
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Person To Contact:
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Telephone Number:

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Date:
October 27, 2014

Legend:

Taxpayer =

Year 1 =

Year 2 =

Partnership =

Portfolio Companies =

Accounting Firm =

Date =

Dear

This is in response to a recent letter requesting an extension of time for Taxpayer to make late elections under section 163(d)(4)(B) of the Internal Revenue Code for Year 1 and Year 2. These elections will seek to include part of qualified dividends and/or net capital gains from the disposition of property held for investment in investment income for Year 1 and Year 2. See section 163(d)(4)(B) of the Internal Revenue Code and section 1.163(d)-1 of the Income Tax Regulations.

The request to make the late election is based on sections 301.9100-1 and 301.9100-3 of the Procedure and Administration Regulations.

FACTS

Taxpayer is an individual who files Form 1040 on a calendar year basis. The years at issue are Year 1 and Year 2.

Taxpayer is the principal owner of Partnership, a limited liability company that is currently taxed as a partnership for federal tax purposes. Partnership holds interests in Portfolio Companies. Portfolio Companies are Subchapter C corporations that are each engaged in an active trade or business. Partnership has individuals that provide back office support for Portfolio Companies. Partnership's activity is a trade or business activity within the meaning of section 162 of the Code.

For Year 1 and Year 2, Partnership had interest expense that was attributable to debt that had financed the acquisition of the Portfolio Companies.

For Year 1 and Year 2, Partnership engaged Accounting Firm to prepare its tax returns. Accounting Firm also provided Taxpayer with information relevant to the preparation of his individual returns.

On the relevant tax returns for both Year 1 and Year 2, Partnership's interest expense associated with the acquisition of Portfolio Companies was erroneously classified as trade or business interest expense associated with Partnership's trade or business activity. At the time the relevant tax returns were filed, all parties believed that the interest expense had been properly classified.

Taxpayer now believes that the activity of holding shares in Portfolio Companies is an investment activity and should not be considered a part of the management trade or business activity conducted by Partnership.

On Date, Taxpayer received notice that his Year 1 tax return was under audit by the Internal Revenue Service. As part of the audit, Taxpayer voluntarily disclosed that the classification of the interest expense on the original returns was erroneous.

By affidavit, Accounting Firm has confirmed that its error led to the interest expense being inadvertently classified as a trade or business expense on the returns of Taxpayer and Partnership for Year 1 and Year 2.

If the interest expense had been properly characterized, Taxpayer would have been subject to the limitation on the deduction of investment interest expense contained in section 163(d) unless Taxpayer elected to treat amounts of capital gain and qualified dividend income as "investment income" under section 163(d)(4)(B).

Accordingly, Taxpayer submitted a request for relief under section 301.9100-3 to make late elections to treat part of capital gain and qualified dividend income as investment income in order to fully deduct the investment interest expense at issue.

The examining agent does not object to the granting of Taxpayer's request to make the late elections at issue.

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 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 the 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
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> (iii) so much of the net capital gain referred to in clause (ii)(II) (or, if lesser, the net gain referred to in clause (ii)(I)) as Taxpayer elects to take into account under this clause.

Additionally section 163(d)(4)(B) provides that "net investment income" shall include qualified dividend income (as defined in section 1(h)(11)(B)) only to the extent the taxpayer elects to treat such income as investment income for purposes of this subsection.

To the extent relevant here, section 1.163(d)-1(b) 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.

Taxpayer now requests an extension of time to make the election under section 163(d)(4)(B)(iii). Taxpayer's situation is analogous to other taxpayers who: (a) have not made a particular election provided in the regulations because of inadequate or incorrect advice from knowledgeable tax professionals; and (b) subsequently seek extensions of time under section 9100 of the Regulations on Procedure and Administration. *See* Rev. Rul. 83-74, 1983-1 C.B. 112.

Sections 301.9100-1 through 301.9100-3 provide the standards the Commissioner uses to determine whether to grant an extension of time to make a regulatory election.

Section 301.9100-1(b) 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) 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.

In this case, Taxpayer has represented that Taxpayer is not foreclosed from being granted an extension of time under section 9100 of the Regulations on Procedure and Administration based on any condition contained in section 301.9100-1.

Section 301.9100-3(a) 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) 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;
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> (ii) inadvertently failed to make the election because of intervening events beyond the taxpayer's control;
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> (iii) failed to make the election because, after exercising due diligence, the taxpayer was unaware of the necessity for the election;
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> (iv) reasonably relied on the written advice of the Service; or
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> (v) reasonably relied on a qualified tax professional, and the tax professional failed to make, or advise Taxpayer to make the election.

In this case, Taxpayer has represented that Taxpayer acted reasonably and in good faith because Taxpayer reasonably relied on a qualified tax professional, and the tax professional failed to make, or advise Taxpayer to make, the election. This

representation is supported by an affidavit from Accounting Firm. Thus, Taxpayer is not foreclosed from being granted an extension of time under section 9100 of the Regulations on Procedure and Administration based on section 301.9100-3(b)(1).

Under section 301.9100-3(b)(3), a taxpayer will not be considered to have acted reasonably and in good faith if 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 Taxpayer requests relief (taking into account any qualified amended return filed within the meaning of § 1.6664-2(c)(3)) and the new position requires a regulatory election for which relief is requested;
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> (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.

In this case, Taxpayer has represented that none of the factors set forth in section 301.9100-3(b)(3) above apply. Thus, Taxpayer is not foreclosed from being considered to have acted reasonably and in good faith by any of the conditions contained section 301.9100-3(b)(3).

Section 301.9100-3(c)(1) provides that the Commissioner will grant a reasonable extension of time to make a regulatory election only when the interests of the Government will not be deemed to be prejudiced by the granting of relief. Under paragraph (c)(1)(i), the interests of the government are deemed to be 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 (taking into account the time value of money). Under paragraph (c)(1)(ii), the interests of the government are ordinarily prejudiced if the taxable year in which the regulatory election should have been made is closed by the period of limitations on assessment under section 6501(a) before the taxpayer's receipt of a ruling granting relief under this section. Paragraph (c)(1)(ii) provides that the IRS may condition a grant of relief on the taxpayer providing the IRS with a statement from an independent auditor certifying that the interests of the government are not prejudiced.

In this case, Taxpayer has represented that Taxpayer is not foreclosed from relief by any of the conditions contained section 301.9100-3(c)(1).

CONCLUSION

The Commissioner consents to an extension of time (to 60 days following the date of this ruling) for Taxpayer to make the elections at issue for Year 1 and Year 2 pursuant to section 163(d)(4)(B).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to Taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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 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, it is subject to verification by the Tax Court or by any party with jurisdiction over the matter within the Internal Revenue Service.

Sincerely,

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Thomas D. Moffitt
Chief, Branch 2
(Income Tax & Accounting)