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Date:  
November 12, 2014

LEGEND:

Taxpayer =  
Executor =

LLC =  
Tax Matters Partner for LLC =  
Company =  
Tax Advisor 1 =  
Tax Advisor 2 =  
Year 1 =  
Year 2 =  
Year 3 =  
X% =  
\$a =

Dear :

This letter responds to a letter ruling request, originally dated May 21, 2014, submitted on behalf of Taxpayer. Taxpayer requests an extension of time under §§ 301.9100-1 and 301.9100-3 of the Procedure and Administration Regulations to make an election under § 108(c)(3)(C) of the Internal Revenue Code and § 1.108-5 of the Income Tax Regulations, to exclude income resulting from the discharge of qualified real property business indebtedness and to reduce the basis of depreciable real property, effective for Taxpayer’s Year 1 tax return.

FACTS

Taxpayer, an individual taxpayer, died in Year 1. Prior to his death, Taxpayer owned an X% interest in LLC. LLC is a domestic limited liability company that is taxed as a partnership. LLC's primary asset is a commercial building, which formerly was leased to Company. Prior to Year 1, Company closed the location leased from LLC, and the property has been vacant. In Year 1, the debt secured by this property was restructured, reducing the outstanding balance by approximately \$a. Executor<sup>1</sup> represents that the original debt has been incurred to acquire and construct the building, and as such constitutes qualified real property business indebtedness as defined in § 108(c)(3).

While these events were taking place, Tax Advisor 1 discussed with LLC the tax consequences of this debt restructuring, including the treatment of the discharge of qualified real property business indebtedness. LLC and Tax Advisor 1 agreed that elections pursuant to § 108(c)(3)(C) were advisable and would be made by the members of LLC.

In March of Year 2, Tax Advisor 1 prepared a draft of the Year 1 Form 1065 for LLC. The primary purpose of this draft was to prepare the Schedule K-1s that the LLC owners could use to complete their Year 1 personal income tax returns. The LLC's Year 1 tax return could not be completed at this time, however, because one of the owners, Taxpayer, died during Year 1. Therefore, LLC waited for the completion of a valuation of the real estate. This was necessary to properly report the § 743(b) adjustment attributable to the decedent's successor in interest.

One of the consequences of the return's preparation in draft form was that the review was focused primarily on the amounts reported on the K-1s. Relatively little time was spent on disclosures, including information relevant to the debt restructuring. As a consequence, the fact that partners needed to explicitly make the § 108(c)(3)(C) election on their tax returns by completing Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness, was overlooked when Tax Advisor 1 prepared the Year 1 tax returns for Taxpayer and the other partners. However, Tax Advisor 1 prepared the LLC's Year 1 tax return with the exclusion of income as if the § 108(c)(3)(C) election had been made. In doing so, LLC applied the limitations outlined in § 108(c)(2) – ultimately limiting the income exclusion to the aggregate adjusted basis of depreciable real property held immediately prior to the discharge. The amount excluded was applied to reduce the basis of the depreciable real property to zero. The excess was included in LLC's taxable income. Subsequently, LLC's Year 1 tax return was completed and filed.

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<sup>1</sup> Executor represents Taxpayer's estate. Hereafter in this letter, reference to "Taxpayer" refers to the deceased Taxpayer or to Executor interchangeably depending on the context (i.e., before or after deceased Taxpayer's death).

In December of Year 2, LLC engaged Tax Advisor 2 to succeed Tax Advisor 1 as the provider of LLC's tax services. In Year 3, Tax Advisor 2 discovered that no disclosure regarding the debt forgiveness was made in LLC's Year 1 tax return. Furthermore, there was also no cancellation of indebtedness (COD) income included on the Schedule K-1s as a flow-through item. Although the partners of LLC had been informed that Tax Advisor 1 would prepare all necessary disclosures and forms, none of the partners' tax returns included Form 982 or any other disclosure related to the debt forgiveness. As such, none of the partners had made the § 108(c)(3)(C) election. Taxpayer, Tax Matters Partner for LLC, and Tax Advisor 1 submitted affidavits consistent with the above facts.

Taxpayer represents that upon receipt of a favorable ruling, an amended return will be filed for Taxpayer to make the election under § 108(c)(3)(C). The amended return will include Form 982 along with a copy of this ruling. No further adjustments would be required to Taxpayer's tax return because prior returns of LLC and the partners (including Taxpayer) were prepared as if the partners had made the § 108(c)(3)(C) election.

#### LAW

Section 108(a)(1)(D) provides that gross income does not include any amount that (but for § 108(a)) would be includible in gross income by reason of the discharge of indebtedness if, in the case of a taxpayer other than a C corporation, the indebtedness discharged is qualified real property business indebtedness.

Section 108(c)(2) provides, in general, that the amount excluded under § 108(a)(1)(D) with respect to any qualified real property business indebtedness shall not exceed the excess of the outstanding principal amount of such indebtedness (immediately before the discharge) over the fair market value of the real property described in § 108(c)(3)(A) (as of such time).

Section 108(c)(3)(C) requires a taxpayer to make an election to exclude COD income under § 108(a)(1)(D).

Section 108(d)(6) provides that in the case of a partnership, § 108(a) and § 108(c) are applied at the partner level.

Section 1.108-5(b) provides that the election under § 108(c)(3)(C) is made on the timely filed (including extensions) federal income tax return for the taxable year in which the taxpayer has discharge of indebtedness income that is excludible from gross income under § 108(a). The election is made on a completed Form 982 in accordance with that Form and its instructions.

Sections 301.9100-1 through § 301.9100-3 provide the standards that the Service will use to determine whether to grant an extension of time to make a regulatory election. Section 301.9100-3(a) provides that requests for extension of time for regulatory elections (other than automatic extensions covered in § 301.9100-2) will be granted when the taxpayer provides evidence (including affidavits) to establish that the taxpayer acted reasonably and in good faith and the grant of relief will not prejudice the interests of the Government.

Under § 301.9100-3(b) a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional and the tax professional failed to make, or advise the taxpayer to make, the election. However, a taxpayer is not considered to have reasonably relied on a qualified tax professional if the taxpayer knew or should have known that the professional was not competent to render advice on the regulatory election or was not aware of all relevant facts. In addition, § 301.9100-3(b)(3) provides that a taxpayer is deemed not 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 § 6662 at the time the taxpayer requests relief and the new position requires or permits a regulatory election for which relief is requested;
- (ii) Was informed in all respects of the required election and related consequences, but chose not to make the election; or
- (iii) Uses hindsight in requesting relief.

Section 301.9100-3(c)(1) provides that the Commissioner will grant a reasonable extension of time to make the regulatory election only when the interests of the Government will not be prejudiced by the granting of relief.

Section 301.9100-3(c)(1)(i) provides that 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 (taking into account the time value of money). Similarly, if the tax consequences of more than one taxpayer are affected by the election, the Government's interests are prejudiced if extending the time for making the election may result in the affected taxpayers, in the aggregate, having a lower tax liability than if the election had been timely made.

Section 301.9100-3(c)(1)(ii) provides 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 year that would have been affected by the election had it been timely made

are closed by the period of limitations on assessment under § 6501(a) before the taxpayer's receipt of a ruling granting relief under this section.

## ANALYSIS

The information and representations made by Taxpayer establish that Taxpayer acted reasonably and in good faith. Taxpayer reasonably relied on Tax Advisor 1 to prepare federal income tax returns for LLC and Taxpayer for Year 1. Furthermore, Taxpayer is not seeking to alter a return position for which an accuracy-related penalty has been or could be imposed under § 6662 at the time relief is requested. Taxpayer did not affirmatively choose not to make the election. Rather, Taxpayer anticipated that Tax Advisor 1 would prepare the appropriate election. Taxpayer is not using hindsight in requesting relief. It was Taxpayer's expectation that the debt relief qualified for § 108(a)(1)(D) treatment.

Additionally, based on the facts of the case provided, granting an extension will not prejudice the interests of the Government. Granting relief would simply allow Taxpayer to file an amended tax return for Year 1 consistent with how the original tax return was filed previously – as if the election had been made. Taxpayer represents that none of the years impacted by this late election are closed by the period of limitations on assessments under § 6501(a).

## RULING

Based upon our analysis of the facts as represented, we conclude that Taxpayer acted reasonably and in good faith, and granting relief will not prejudice the interests of the government. Thus, the requirements of §§ 301.9100-1 and 301.9100-3 are met. Accordingly, we grant Taxpayer an extension of 45 days from the date of this letter to file an amended return to make the election under § 108(c)(3)(C) and § 1.108-5(b). The election is to be made on Form 982.

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.

Except as expressly provided herein, we do not express or imply an opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, this letter does not rule on whether the amount of income at issue is properly treated as COD income under § 61(a)(12). In addition, this letter also does not rule on whether the income in fact qualifies for exclusion from income under § 108 (including § 108(c)(3)).

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 in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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 Taxpayer and the first-listed authorized representative. We are also sending a copy of this letter to the appropriate operating division director. Enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110.

Sincerely,

Michael J. Montemurro  
Chief, Branch 4  
Office of Associate Chief Counsel  
(Income Tax & Accounting)

Enclosure (1)