**Internal Revenue Service**

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
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CC:ITA:B02
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Date:
August 09, 2017

TY:

Taxpayer =
Firm 1 =
Firm 2 =
Year 1 =
Year 2 =
Year 3 =
Year 4 =
Year 5 =

Dear :

This is in response to your letter dated May 10, 2017 requesting permission to revoke an election to treat net long-term capital gains as investment income for Year 1, Year 2, and Year 3 under §§ 163(d)(1) and 163(d)(4)(B) of the Internal Revenue Code and § 1.163(d)-1 of the Income Tax Regulations.

**FACTS**

The information Taxpayer submitted and the representations made are as follows:

During Year 1, Year 2, and Year 3, Taxpayer was employed as an analyst for a financial management services partnership and received income in the form of carried interest from the partnership. The Schedule K-1, Partner's Share of Income, Deductions, and Credits, etc., takes the position that the partnership is engaged in the active conduct of a business as a trader in securities. Taxpayer is actively engaged in the business of the partnership and materially participates in the operations of the partnership.

Taxpayer timely filed Forms 1040, Individual Income Tax Return, for Year 1, Year 2, and Year 3. Taxpayer's returns for Year 1, Year 2, and Year 3 were prepared by Firm 1, an accounting firm. In preparing the returns, Firm 1 included Taxpayer's share of the partnership's investment interest expense on Form 4952, Investment Interest Expense Deduction. As a result, Taxpayer elected to treat a portion of the net long-term capital gains as investment income as provided in §§ 163(d)(4)(B) and 1.163(d)-1.

In Year 5, Taxpayer engaged Firm 2 to prepare his Year 4 return. Firm 2 reviewed Taxpayer's prior returns for Year 1, Year 2, and Year 3, which had been prepared by Firm 1, and discovered that Firm 1 erroneously included Taxpayer's share of the partnership's investment interest expense on Form 4952 for those years. Firm 2 determined the amounts should have been reported in Part II, Column (h) of Schedule E, Supplemental Income and Loss, of the Form 1040, and that Taxpayer's election to treat net long-term capital gains as investment income was not necessary based on Taxpayer's material participation in the partnership. Firm 2 then advised the Taxpayer to file for relief with the IRS to revoke the elections. Firm 1 acknowledged that Taxpayer provided all of the relevant facts to prepare Taxpayer's returns, but Firm 1 neglected to consider this information when it prepared Taxpayer's returns. Taxpayer relied on Firm 1 to advise him on his tax returns. Taxpayer was not aware that Firm 1 made the elections, and did not become aware of the elections until Firm 2 brought to his attention that the elections had been erroneously made. Taxpayer's Forms 1040 for taxable Year 1, Year 2, or Year 3 are not currently under examination.

**LAW & ANALYSIS**

Section 163(d) 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.

Section 163(d)(4)(B) defines the term, "investment income," in general, as 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)(II) (or if lesser, the net gain referred to in clause (ii)(I)) as the taxpayer elects to take into account under this clause.

Section 1.163(d)-1(b) provides that an election for net capital gain under § 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 net capital gain is recognized. The election is to be made on a Form 4952, Investment Interest Expense Deduction.

Section 1.163(d)-1(c) provides that the election under § 163(d)(4)(B) is revocable with the consent of the Commissioner.

Taxpayer is requesting permission to revoke the elections to treat net long-term capital gains as investment income. This situation is analogous to situations concerning taxpayers who did not make 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 §§ 301.9100-1 and 301.9100-3 of the Procedure and Administration regulations. *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 extensions of time for making regulatory elections. Section 301.9100-1(b) defines the term "regulatory election" to include an election whose due date is prescribed by a regulation, a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin. Section 301.9100-1(c) provides, in part, that the Commissioner may grant a reasonable extension of time to make a regulatory election.

Section 301.9100-3(a) provides that requests for extensions of time for regulatory elections will be granted when the taxpayer provides evidence (including affidavits described in the regulations) 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 Internal Revenue Service (IRS);
(ii) failed to make the election because of intervening events beyond the taxpayer's control;
(iii) failed to make the election because, after exercising reasonable diligence, the taxpayer was unaware of the necessity for the election;
(iv) reasonably relied on the written advice of the IRS; or
(v) reasonably relied on a qualified tax professional, and the tax professional failed to make, or advise the taxpayer to make, the election.

Under § 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 § 6662 at the time the 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;

(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 due date for making the election that make the election advantageous to a taxpayer, the IRS will not ordinarily grant relief.

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

Taxpayer's election is a regulatory election, as defined in § 301.9100-1(b), because the due date of the election is prescribed in § 1.163(d)-1(b). Based upon our analysis of the facts and representations provided, Taxpayer acted reasonably and in good faith, and granting relief will not prejudice the interests of the Government. Therefore, the requirements of §§ 301.9100-1 and 301.9100-3 have been met. In addition, granting the revocations in the present situation would not cause undue administrative burden, nor would it be inconsistent with the objectives of the underlying statute and the regulatory election.

**CONCLUSION**

The consent of the Commissioner is hereby granted to revoke the elections under § 163(d)(4)(B) to treat net long-term capital gains as investment income for Year 1, Year 2, and Year 3. The extension of time to revoke these elections shall be for a period of 60 days from the date of this ruling and is to be made by filing amended returns for Year 1, Year 2, and Year 3.

This ruling is limited to providing an extension of time to revoke the elections Taxpayer previously made under § 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. In particular, no opinion is expressed on (1) whether any of the interest expense would qualify as deductible

interest expense, (2) the proper characterization of any income of Taxpayer (e.g. as carried interest) and (3) which tax rate would be applicable to any income of Taxpayer.

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.

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.

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 representatives.

Sincerely,

Norma C. Rotunno
Senior Technician Reviewer, Branch 2
(Income Tax & Accounting)

cc: