Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Date:
November 29, 2021

In Re:

LEGEND

Taxpayer	=
Tax Director	=
Borrowers	=
Underwriter	=
Counsel	=
Accounting Firm	=
Business 1	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Taxable Year 1	=
Taxable Year 2	=
Taxable Year 3	=
Taxable Year 4	=
Taxable Year 5	=
Taxable Year 6	=
Taxable Year 7	=
Taxable Year 8	=
Taxable Year 9	=

Dear :

This letter responds to a letter ruling request dated Date 1, submitted by Counsel on behalf of Taxpayer. Taxpayer requests the consent of the Commissioner of the Internal Revenue Service (Service) to revoke elections made for Taxable Years 4 through 6 under section 1.263(a)-5(d)(4) of the Income Tax Regulations, to capitalize intercompany underwriting fees incurred by Taxpayer and another member of its consolidated group in connection with certain borrowings.

FACTS

Taxpayer represents that the facts are as follows:

Taxpayer is engaged in Business 1 and is the common parent of an affiliated group of corporations that files a consolidated federal income tax return on a calendar-year basis. During the years at issue, all members of Taxpayer's consolidated group employed the overall accrual method of accounting.

Taxpayer inadvertently elected under section 1.263(a)-5(d)(4) to capitalize certain expenses in pursuit of various borrowings by Borrowers (members of Taxpayer's consolidated group) from Taxable Year 1 through Taxable Year 8.

The expenses in question were fees that Borrowers incurred and paid to Underwriter for conventional underwriting services performed by employees of Underwriter. Underwriter acted as bookrunner and principal underwriter on Borrower's unsecured borrowings, and it received fees from Borrowers in connection with numerous borrowings during the taxable years at issue.

The fees paid to Underwriter, like those paid to the unrelated underwriters that frequently participated in the same issuances, were ordinarily based on underwriting volume and maturity, and were consistent with standard market practice.

Taxpayer generally eliminates intercompany transactions for consolidated reporting under U.S. Generally Accepted Accounting Principles (GAAP). However, fees paid between different segments within Taxpayer's consolidated group are treated similar to transactions with a third party. Taxpayer's typical practice for underwriting activity is to apply GAAP as if each of its business segments were transacting with a third party. Therefore, for financial reporting purposes, Taxpayer capitalizes the underwriting fees

and amortizes them over the life of the debt on a straight-line basis. The , which includes Underwriter, reports the fees as current revenue. This method of reporting accelerates the Taxpayer's consolidated group's financial accounting income as a result of dealings that take place entirely within the Taxpayer's consolidated group, and the accelerated income is later reversed as the outlays are amortized. This method of reporting is not in accordance with GAAP but is tolerated for financial statement purposes if amounts involved are not large enough to affect the income of the reporting entity.

The accounting exception for capitalization of the intercompany underwriting fee expense was consistently approved by Taxpayer's controllers and the group responsible for corporate accounting policies, and external tax and audit consultants, including Accounting Firm. Taxpayer generally follows financial accounting treatment for tax purposes unless a reason for deviation is known and the corporate tax function of Taxpayer was not aware of the financial accounting treatment applied to intercompany underwriting fees. By following book treatment, Taxpayer has consistently capitalized underwriting expenses paid to Underwriter for tax purposes during the Taxable Years 1 through 8.

Taxpayer discovered the financial accounting treatment applied to intercompany underwriting fees as part of a broader tax review in or around February or March of Taxable Year 9, and members of the corporate tax function realized the financial accounting treatment of the intercompany underwriting fees presented significant tax issues. After further investigation, Taxpayer's tax staff became aware of the election in section 1.263(a)-5(d)(4) in late Taxable Year 9. By that time, it was too late to change the treatment of intercompany underwriting fees on the Taxable Year 8 consolidated tax return. The decision was made to seek consent to revoke the inadvertent elections that Taxpayer's group had made for Taxable Years 1 through 8.

Borrowers continue to issue debt and incur similar fees. Starting in Taxable Year 9, Taxpayer will currently deduct the underwriting fees paid by Underwriter. The revised treatment will match expense timing to fee revenue and better reflect the Taxpayer's consolidated group's income.

In a prior ruling issued to Taxpayer on Date 4 (Original Ruling), Taxpayer's request to revoke its inadvertent elections under 1.263(a)-5(d)(4) for Taxable Years 1 through 8 was denied for Taxable Years 1 through 3 and granted for Taxable Years 7 and 8. At the time Original Ruling was under consideration, outstanding Notices of Proposed Adjustment (NOPAs) were under review by the Service's Office of Chief Counsel for Taxable Years 4 through 6. At the Service's request, Taxpayer withdrew its request for relief for Taxable Years 4 through 6, and Taxpayer was advised to consider resubmitting its request for Taxable Years 4 through 6 after resolution of the NOPAs.

In this resubmitted ruling request, Taxpayer is seeking permission to revoke its inadvertent elections under section 1.263(a)-5(d)(4) for Taxable Years 4 through 6. For

Taxable Years 4 through 6, the period of limitations on assessment and refund (including extensions) is open under section 6501(a) of the Internal Revenue Code as of the issuance date of this ruling letter, and will not expire until Date 5.

REPRESENTATIONS

In seeking this ruling, Tax Director and Taxpayer has made the following representations to the Service (these representations apply without regard to current deductions taken on amended returns for Taxable Years 7 and 8 as a result of Original Ruling):

1) Tax Director is not aware of the Taxpayer ever currently deducting (as opposed to capitalizing and amortizing) the type of fees at issue in the ruling request from 2004, the year in which section 1.263(a)-5 was published. Taxpayer first deducted the fees on its Taxable Year 9 consolidated return after submitting the request for Original Ruling;

2) Tax Director and Taxpayer's corporate tax group were not aware of the election at issue in time to correct the treatment of underwriting fees for Taxable Years 1 through 8;

3) Taxpayer's request for relief did not stem from hindsight as no event subsequent to the filing of any of the tax returns would have caused Tax Director to advise Taxpayer to deduct the underwriting fees on its original returns;

4) Taxpayer's taxable income for Taxable Years 1 through 8 were sufficient to absorb the increased deductions in each tax year such that a change from capitalizing to deducting would not trigger any net operating losses;

5) Tax Director generally asserts that at the time Taxpayer prepared its tax returns for Taxable Years 1 through 8, deducting the underwriting fees would have been expected to produce a current tax benefit, as compared to amortizing them over the term of the respective borrowing;

6) Taxpayer consistently chose tax treatments that reduced income where possible for Taxable Years 1 through 8;

7) During Taxable Years 1 through 8, Tax Director does not recall any circumstances in which Taxpayer intentionally capitalized expenses where it had the opportunity to deduct them or realized income where it had the opportunity to defer that income.

LAW AND ANALYSIS

Section 1.263(a)-5(a) generally provides that a taxpayer must capitalize an amount paid to facilitate certain enumerated transactions.

Section 1.263(a)-5(a)(9) provides that a borrowing, including an issuance of debt, is a transaction covered under the general rule provided in section 1.263(a)-5(a).

Section 1.263(a)-5(d)(1) generally provides, in part, that employee compensation is treated as an amount that does not facilitate a transaction described in section 1.263(a)-5(a).

Section 1.263(a)-5(d)(4) provides that notwithstanding the general rule provided in section 1.263(a)-5(d)(1), a taxpayer may elect to capitalize employee compensation as amounts that facilitate a transaction. The election is made separately for each transaction and applies to employee compensation, overhead, or de minimis costs, or any combination thereof. The election is made by treating the amounts to which the election applies as amounts that facilitate the transaction in the taxpayer's timely filed original federal income tax return (including extensions) for the taxable year during which the amounts are paid. The election is revocable with respect to each taxable year for which it was made only with the consent of the Commissioner.

Section 1.263(a)-5(d)(2)(ii) provides that in the case of an affiliated group of corporations filing a consolidated federal income tax return, a payment by one member of a group to a second member of the group for services performed by an employee of the second member is treated as employee compensation if the services were provided at a time during which both members were affiliated.

Taxpayer requests permission to revoke its elections under section 1.263(a)-5(d)(4) for Taxable Years 4 through 6. The default rule for intercompany underwriting fees like those incurred by Taxpayer and Borrowers and paid to Underwriter is not to capitalize them, but rather to treat them as a currently deductible expense when incurred under section 162. But by following its financial accounting treatment, Taxpayer departed from the default tax rule, and unknowingly met the requirements for a regulatory election under section 1.263(a)-5(d)(4).

Taxpayer's request to revoke its elections resulted from the Taxpayer's corporate tax function being unaware of the accounting exception for capitalization of the intercompany underwriting fee expense that was consistently approved and reviewed by Taxpayer's controllers and the group responsible for corporate accounting policies, and external tax consultants. This situation is analogous to those situations concerning taxpayers who have not made a particular election provided in the regulations because after exercising due diligence (taking into account the taxpayer's experience and the complexity of the return or issue), the taxpayer was unaware of the necessity for the election, or because taxpayers received inadequate or incorrect advice from either an attorney or accountant knowledgeable in tax matters, and subsequently seek

extensions of time under section 301.9100-1 of the Procedure and Administration Regulations in which to make the election. *See* Rev. Rul. 82-203, 1982-2 C.B. 109.

Under section 301.9100-1, the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in sections 301.9100-2 and 301.9100-3 to make a regulatory election. Sections 301.9100-1 through 301.9100-3 provide the standards that the Commissioner will use to determine whether to grant an extension of time to make an election. Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides extensions of time for making elections that do not meet the requirements of section 301.9100-2.

Section 301.9100-3(a) provides that requests for relief under section 301.9100-3 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. The application of similar factors is appropriate to determine whether taxpayers may revoke elections made under section 1.263(a)-5(d)(4).

Section 301.9100-3(b)(1) provides that a taxpayer is 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) 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 (taking into account the taxpayer's experience and the complexity of the return or issue), 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, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election.

Section 301.9100-3(b)(2) provides that a taxpayer will not be considered to have reasonably relied on a qualified tax professional if the taxpayer knew or should have known that the professional was not:

(i) Competent to render advice on the regulatory election; or
(ii) Aware of all relevant facts.

Section 301.9100-3(b)(3) provides that a taxpayer will be deemed to have not 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, and the new position requires or permits 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.

Section 301.9100-3(c)(1)(i) provides 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.

As noted above, section 301.9100-3(b)(1)(i)-(v) provides factors which indicate whether a taxpayer acted reasonably and in good faith. Taxpayer asserts that the first, third and fifth factors apply. Taxpayer notes that its capitalization of the costs at issue were never discussed with the Service. Taxpayer asserts that it exercised reasonable diligence and was unaware of the opportunity to not capitalize the costs despite its employment of numerous qualified tax professionals.

Taxpayer stated that none of the factors under section 301.9100-3(b)(3) which indicate a taxpayer did not act reasonably or in good faith are applicable. Taxpayer asserts that it is not seeking to alter a return position for which a penalty could be imposed under section 6662, nor is it changing a position of which it was informed of the tax consequences.

Section 301.9100-3(b)(3)(iii) provides that a taxpayer is deemed to have not acted in good faith if it has used hindsight in requesting relief. The section states that if "specific facts changed since the due date for making the election that make the election advantageous to a taxpayer, the IRS will not ordinarily grant relief. In such a case, the IRS will grant relief only when the taxpayer provides strong proof that the taxpayer's decision to seek relief did not involve hindsight."

On December 22, 2017, Public Law 115-97, 131 Stat. 2054, commonly referred to as the Tax Cuts and Jobs Act (TCJA) was enacted. TCJA lowered the U.S. federal income tax rate as applied to C Corporations from 35% to 21% for taxable years beginning after December 31, 2017. Taxpayer filed its U.S. federal income tax returns for Taxable Years 4 through 6 prior to the passage and enactment of TCJA. The decrease of the U.S. federal income tax rate from 35% to 21% constitutes a change in facts which makes the sought-after relief (the revocation of the election under section 1.263(a)-5(d)(4)) advantageous to Taxpayer because tax deductions taken in tax years beginning before January 1, 2018 are generally worth 35% while those taken in tax years beginning after December 31, 2017 are generally worth 21%. In such a case, taxpayers generally must provide "strong proof" that the decision to seek relief did not involve hindsight.

Taxpayer's and Tax Director's representations and supporting documents indicate that notwithstanding the fact that deductions utilized in pre-TCJA taxable years are more beneficial than deductions utilized in post-TCJA taxable years, Taxpayer did not engage in hindsight in determining whether to revoke the election. Specifically, Taxpayer's representations and supporting documents indicate that at the time the tax returns for Taxable Years 4 through 6 were filed, Taxpayer generally would have benefitted from deducting the underwriting costs instead of amortizing them over the respective life of the borrowing. Additionally, Tax Director represented that Taxpayer never deducted the fees at issue prior to Taxable Year 1. Tax Director represented that Taxpayer had no reason to defer any of the deductions and the Taxpayer's tax returns confirm that Taxpayer had ample taxable income to utilize all the deductions. Additionally, Taxpayer generally adopted a policy of maximizing current year deductions and deferring taxable income to the extent possible.

Based on the facts submitted and the representations made, we conclude that Taxpayer has provided "strong proof" that its decision to seek relief with respect to Taxable Years 4 through 6 did not involve hindsight.

CONCLUSIONS

Based solely on the facts submitted and the representations made, we conclude that with respect to Taxpayer's request to revoke elections for Taxable Years 4 through 6, application of factors similar to the requirements of sections 301.9100-1 and 301.9100-3 of the regulations have been satisfied. Accordingly, we conclude that Taxpayer acted reasonably and in good faith, and that granting the request will not prejudice the interests of the Government.

Accordingly, Taxpayer is granted 150 calendar days from the date of this letter to amend its tax returns to revoke its elections under section 1.263(a)-5(d)(4) for Taxable Years 4 through 6. These revocations must be made in a written statement filed with Taxpayer's amended consolidated federal tax returns for Taxable Years 4 through 6. In addition, a copy of this letter must be attached to such amended consolidated federal tax returns. The amended consolidated federal income tax returns for Taxable Years 4 through 6 must include the adjustments to tax liability and adjustments to taxable income resulting from the deduction of intercompany underwriting fees rather than capitalization, and any collateral adjustments to taxable income or tax liability resulting from the revocations. Additionally, Taxpayer must make the appropriate adjustments to subsequent taxable years that are impacted by the revocation of the elections under section 1.263(a)-5(d)(4) in Taxable Years 4 through 6 through affirmative adjustments made in conjunction with the Examination/Audit Team assigned to the Taxpayer.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, a taxpayer filing its return electronically may satisfy this requirement by attaching a statement to its return that provides the date and control number of the letter ruling.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal income tax consequences arising from the facts described above under any other provision of the Code or regulations. Specifically, no opinion is expressed or implied on whether any of the borrowings at issue are borrowings under section 1.263(a)-5(a), or whether the underwriting fee expenses at issue are properly deductible as employee compensation under section 1.263(a)-5(d)(1) or section 1.263(a)-5(d)(2)(ii).

The rulings contained in this letter are based on 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.

The rulings in this letter are 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 provisions of the power of attorney currently on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter to the appropriate operating division director.

Sincerely,

SUSIE K. BIRD
Senior Counsel, Branch 3
(Income Tax & Accounting)
Office of Chief Counsel

Enclosure: Copy for Section 6110 purposes

cc: