

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:

May 17, 2000

Legend:

Taxpayer =

Year 1 =

Dear

This is in response to your letter dated December 20, 1999. In your letter you requested an extension of time on behalf of Taxpayer to make a late election to treat capital gains as investment income under sections 163(d)(1) and 163(d)(4)(B) of the Internal Revenue Code for Year 1. Additionally, you requested a revocation under section 1.163(d)-(1)(c) of the Income Tax Regulations of the election previously made to treat capital gains as investment income under section 163(d)(1) for year 1. 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 timely filed Form 1040, Individual Income Tax Return, for year 1. The return was prepared using a computerized tax return preparation software program sold to the general public. Taxpayer's return included Form 4952, Investment Interest Expense Deduction. It is represented that the tax return preparation program does not calculate the proper amount of capital gain a taxpayer should include in investment income, or otherwise provide guidance or advice on how to calculate the proper amount. Instead, the amount is entered manually by a user of the software program. In prior years, Taxpayer had consistently elected on Form 4952 to include all net capital gain in investment income. In those years, unlike the year at issue, Taxpayer's investment interest expense exceeded the capital gains and other investment income. It is represented that Taxpayer merely followed that practice, in electing to include all net capital gain in investment income on Form 4952, for year 1.

The effect of electing to treat all of Taxpayer's net capital gain as investment income was to subject the "excess" capital gains to tax at ordinary income tax rates. Only a small portion of Taxpayer's capital gain income was needed to offset Taxpayer's investment interest expense. If Form 4952 had been prepared properly, the "excess"

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capital gains would have been taxed at a lower capital gain tax rate as opposed to the applicable ordinary income tax rate.

Applicable Law

Section 163(d)(1) of the Code 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) of the Code 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
- (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) of the regulations 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.

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.

Sections 301.9100-1 through 301.9100-3 of the Procedure and Administration Regulations provide the standards the Commissioner uses to determine whether to grant an extension of time to make a regulatory 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 301.9100-1(b) of the regulations 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) of the regulations provides that the Commissioner may grant a

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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.

Section 301.9100-3(a) of the regulations 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) of the regulations 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;
- (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.

Section 301.9100-3(b)(3) of the regulations provides that 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 could be imposed under section 6662 at the time the taxpayer requests relief and the new position requires a regulatory election for which relief is requested;
- (ii) was fully informed 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.

Section 301.9100-3(c)(1) of the regulations provides that the Commissioner will grant a reasonable extension of time only when the interests of the Government will not be prejudiced by the granting of relief. Under paragraph (c)(1)(i), 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

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taxpayer would have had if the election had been timely made.

Conclusion

Taxpayer's election is a regulatory election, as defined under section 301-9100-1(b), because the due date of the election is prescribed in the regulations under 1.163(d)-1(b). In the present situation, the requirements of sections 301.9100-1 and 301.9100-3 of the regulations have been satisfied. The information and representations made by Taxpayer establish that Taxpayer acted reasonably and in good faith with this request. Furthermore, granting an extension will not prejudice the interests of the Government. It is represented that there are no current or deferred benefits of electing to treat capital gain as ordinary income in excess of what is required to absorb the investment interest expense. Accordingly, Taxpayer is granted an extension of time for making the election until 60 days following the date of this ruling. The election should be made by filing a revised Form 4952 and Schedule D, and by including a copy of this ruling with an amended return for Year 1. Additionally, Taxpayer is granted consent to revoke the first election made on the Year 1 return.

These rulings are based upon information and representations submitted by Taxpayer and accompanied by a penalty of perjury statement. 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.

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

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

Sincerely yours,
Assistant Chief Counsel
(Income Tax & Accounting)
By: Douglas A. Fahey
Assistant to the Branch Chief, Branch 5
CC:DOM:IT&A:5

Attachments:
Copy of this letter
Copy for section 6110 purposes