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Department of the Treasury

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Date: July 27, 2000

LEGEND:

Taxpayer =
Date A =
Date B =
Date C =
Date D =
Year 1 =
Year 2 =
Year 3 =
Firm A =
Firm B =
Firm C =
Shareholder 1 =
Shareholder 2 =
GP =
$w =
$ww =
$x =
$xx =
$y =
Mr. A =
Mr. B =

Dear

This responds to your letter of December 14, 1999, requesting an extension of time for Taxpayer and its common shareholders to agree to treat an additional amount as a dividend distributed by Taxpayer to its shareholders on Date C, pursuant to the consent dividend procedure of § 565 of the Internal Revenue Code.

FACTS:

Taxpayer is a corporation that elected, under §856(c)(1) of the Code, effective for its taxable year beginning Date A, to be a "real estate investment trust" ("REIT") as defined in §856(a).

Taxpayer has relied on the advice of several outside accountants and attorneys for matters relating to its tax obligations. Specifically, beginning in Date B, Taxpayer retained Firm A to assist it in preparing its Forms 1120 - REIT (U.S. Income Tax Return for Real Estate Investment Trusts) and to counsel it on all matters related to the preparation of tax returns and their underlying schedules. In this connection, Firm A was responsible for computing the amount of "consent dividends" under §565 required for Taxpayer to meet the requirements of §857(a)(1).

On the effective date of its REIT election (Date A), Taxpayer had net built-in gains with respect to certain real property assets. On its Form 1120 - REIT for Year 1, Taxpayer made an election under Notice 88-19, 1988-1 C.B. 486, to have its net built-in gains treated under these rules.[1]

With respect to its Year 2 taxable year, Firm A prepared the returns of Taxpayer and its two shareholders, Shareholder 1 and Shareholder 2, on the basis that Shareholder 1 should agree, under §565, to treat $w as a consent dividend from Taxpayer. Shareholders 1 and 2 were prepared to treat as a dividend any amount that was necessary to comply with the provisions of Part II of subchapter M (§856 et seq.) of the Code. Accordingly, Shareholder 1 executed a Form 972, agreeing to treat the full amount of $w as a dividend. This form was duly filed with Taxpayer's Year 2 return on its extended due date of Date D. Firm A did not prepare a Form 972 for execution by shareholder 2. However, Shareholder 2, on its own income tax return reported $x as a distribution from Taxpayer, as though Shareholder 2 had executed a Form 972 reflecting that amount.[2] Firm A also did not advise Taxpayer that Form 973 (included with Taxpayer's Form 1120 - REIT) needed to be separately signed.

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[1] Notice 88-19 provides (i) that a C corporation with net built-in gains that qualifies to be taxed as a REIT may elect to be subject to rules similar to rules of §1374, and (ii) that the built-in gains of electing REIT's and the corporate-level tax imposed on such gains will be subject to rules similar to the rules relating to "net income from foreclosure property" as defined at §857(b)(4)(B).

[2] Taxpayer does not know why Firm A prepared a Form 972 for Shareholder 1, reflecting the full amount of consent dividends as computed by Firm A, rather than dividing that amount between Shareholder 1 and Shareholder 2. The $x reported by Shareholder 2 was consistent with the proper consent dividend allocable to Shareholder 2 had Firm A's overall determination of the total consent dividends needed been correct.

During Year 3, Taxpayer retained a law firm, Firm B, to provide tax advice. It also retained an accounting firm, Firm C, to replace Firm A in providing tax advice and tax preparation services relating to Year 3 and subsequent taxable years. Neither firm was involved in the preparation of Taxpayer's Year 2 Form 1120 - REIT. Neither firm reviewed the Year 2 return before it was filed.

Shortly after its filing on Date D, Firms B and C reviewed the Year 2 return. From this review, Firms B and C determined: (1) Form 973 should have been signed separately; (2) Shareholder 1 should have agreed to treat an additional $y (or a total of $ww) as a consent dividend from Taxpayer; (3) Shareholder 2 should have signed a separate Form 972; (4) the total amount of the consent dividend that was needed should have been divided between Shareholder 1 and Shareholder 2; and (5) Shareholder 2 should have agreed to treat $xx as a dividend from Taxpayer.

The discrepancy between the aggregate amount of consent dividends as computed, by Firm A on one hand and by Firms B and C on the other, arises from divergent methods of determining, for purposes of §857(a)(1)(A), as applied to a REIT with built-in gains, the sum of "real estate investment trust taxable income" (REITTI) and "net recognized built-in gain" (NRBIG).[3] Firm A prepared Taxpayer's Year 2 Form 1120 -REIT and Shareholder 1's Form 972 based on the theory that the amount of the "deductions for dividends paid" (DDP) required under §857(a)(1)(A) (i.e., the sum of 95% of REITTI for Year 2 and 95% of the excess NRBIG for Year 2 over the tax imposed thereon) could be calculated by netting the Taxpayer's REITTI for Year 2 (which was a negative amount due to the net operating loss deduction) against a positive amount of NRBIG. However, Firms B and C have taken the position that a negative amount of REITTI may not be taken into account to offset positive NRBIG for purposes of §857(a)(1)(A). Accordingly, Firms B and C have calculated that the consent dividend (and resulting DDP) should have been higher than the amounts calculated by Firm A.

To address these problems, including that of insufficient DDP, Firms B and C have advised Taxpayer that Shareholders 1 and 2 should agree to treat additional amounts of $y and $xx, respectively, as dividends from Taxpayer. Shareholders 1 and 2 have agreed to these additional consent dividends. However, because the period for agreeing to treat an amount as a consent dividend expired at the time the Year 2 Form 1120-REIT was due (Date D), Taxpayer has filed a request for an extension of time in which to make a consent dividend election for the Year 2 taxable year under

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[3] Notice 88-19 provides that the §857(a)(1)(A)(ii) distribution requirements applicable to net income from foreclosure property apply to NRBIG. In the case of a REIT with net income from foreclosure property (but without "excess noncash income," as determined under §857(e), §857(a)(1)(A) provides that the deduction for dividends paid (determined without regard to capital gain dividends) must equal or exceed the sum of (i) 95% of the REITTI (determined without regard to deductions for dividends paid and by excluding any net capital gain) and (ii) 95% of the excess of the net income from foreclosure property over the tax imposed thereon.

§§301.9100-1 and 301.9100-3 of the regulations.

The failure to file Forms 972 and 973 for making the consent dividend election in the correct amounts was due to Firm A's error. These facts are verified by sworn affidavits by Mr. A and Mr. B. Mr. A is the Chief Financial Officer of Taxpayer. Mr. B, is the controller of GP, the general partner of Shareholder 1. He is also the treasurer of Shareholder 2.

APPLICABLE LAW AND ANALYSIS:

Section 301.9100-1(c) of the Procedure and Administration Regulations generally provides that the Commissioner, in his discretion, may grant a reasonable extension of time to make a regulatory election.

Section 301.9100-1(b) defines the term "regulatory election" to include an election whose deadline is prescribed by a revenue ruling, revenue procedure, notice or announcement published in the Internal Revenue Bulletin. The consent dividend election is a regulatory election because the deadline for filing the election is prescribed in §1.565-1(b)(3) of the Income Tax Regulations and Rev. Rul. 78-296, 1978-2 C.B. 183.

Section 301.9100-3(a) of the regulations provides, in part, that requests for relief will be granted when the taxpayer provides evidence (including affidavits described in paragraph (e) of this section) to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the government.

Section 301.9100-3(e)(3) provides, in part, that the taxpayer must submit detailed affidavits from the individuals having knowledge or information about the events that led to the failure to make a valid regulatory election and to the discovery of the failure. These individuals must include the taxpayer's return preparer, any individual (including an employee of the taxpayer) who made a substantial contribution to the preparation of the return, and any accountant or attorney, knowledgeable in tax matters, who advised the taxpayer with regard to the election. An affidavit must describe the engagement and responsibilities of the individual as well as the advice that the individual provided to the taxpayer. Each affidavit must include the name, current address, and taxpayer identification number of the individual, and be accompanied by a dated declaration, signed by the individual, which states: "Under penalties of perjury, I declare that I have examined this request, including accompanying documents and that to the best of my knowledge and belief, the request contains all the relevant facts relating to the request, and such facts are true, correct, and complete."

In the present case, the tax return preparer, Firm A, refuses to verify the facts alleged above, or to acknowledge its error by sworn affidavit. However, in view of the sworn affidavits already received and the fact that an incomplete election was prepared

and filed in behalf of Taxpayer by Firm A, we believe Taxpayer should be treated as having satisfied the affidavit requirement.

Section 301.9100-3(b)(1) of the regulations provides, in part, that except as otherwise provided (in paragraphs (b)(3)(i) through (iii) of that section), a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer "(i) Requests relief under this section before failure to make the regulatory election is discovered by 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."

The affidavits presented show that Taxpayer acted reasonably and in good faith. Taxpayer requested relief under this section before failure to make the regulatory election was discovered by the IRS. Moreover, Taxpayer relied entirely on Firm A to prepare its returns and advise it on tax matters during the tax year at issue. Firm A is a well-established accounting firm with a substantial tax accounting practice. There are no facts indicating that such reliance on Firm A's expertise in matters relating to the taxation of REITs was unreasonable.

Section 301.9100-3(b)(3) of the regulations provides, in part, that a taxpayer is 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 §6662 at the time the taxpayer requests relief (taking into account §1.6664-2(c)(3) of this chapter) 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. In connection with hindsight, if specific facts have changed since the due date for making the election that make the election advantageous to the 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.

In the present case, Taxpayer is not seeking to alter its return position in a way that requires or permits a regulatory election for which relief is requested. Taxpayer was previously permitted to make the election up to the time that its Year 2 return was filed.

Taxpayer was informed of the need to make an election under §565 for the Year 2 taxable year and attempted to do so. However, it was ill-advised of the scope of the election that was needed and the processing of the paper needed to make the election was mishandled by its professional advisor. Moreover, there is no indication that Taxpayer is using hindsight, as defined above, in requesting this relief. This request for relief was made within a reasonable time after the close of the taxable year at issue and after the failure to make the election was discovered. Specific facts, material to the issue under consideration, have not changed since the due date for making the election that make the election more advantageous to the taxpayer.

Section 301.9100-3(c)(1)(i) of the regulations 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 made, or any taxable years that would have been affected by the election had it been timely made are closed by the period of limitations on assessment.

In the present case, Taxpayer will not have a lower tax liability in the aggregate for any of the years in which the election will apply than the taxpayer would have had if the election had been timely made (taking into account the time value of money). Also, no taxable year that would be affected by the election, had it been timely made, is closed by the period of limitations on assessment.

Taken together, these disclosed circumstances indicate that the omissions and errors that Taxpayer now seeks to remedy originated from a mistake on the part of its tax advisors, and not from a desire to avoid taxes. Furthermore, there is no indication that any prejudice to the government, as defined herein, will arise as a result of granting this application.

Accordingly, Taxpayer is hereby granted an extension of 45 days from the date of this letter within which it may:

(1) Correct the amount of the § 565 election by filing a corrected Form 972 as to Shareholder 1;

(2) Execute and file a Form 972 with the correctly calculated dividend amount as to Shareholder 2: and

(3) Execute and file Form 973.

Except as specifically ruled above, no opinion is expressed as to the federal tax treatment of the transaction under any other provision of the Code and the Income Tax Regulations that may be applicable or under other general principles of federal income taxation. No opinion is expressed as to the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above ruling.

This ruling is directed only to the taxpayer who requested it. Pursuant to the power of attorney on file in this office, copies of this ruling will be sent to your representatives. Section 6110(k)(3) of the Code provides that a private letter ruling may not be used or cited as precedent.

Sincerely yours,

Associate Chief Counsel
(Income Tax & Accounting)

By Douglas Fahey
Acting Chief, Branch 5

cc: DD -
Attn: Chief, Examination Division