Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
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May 06, 2004

LEGEND:

Taxpayer

Representative =

X1 =

X2 =

X3 =

X4 =

X5 =

X6 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Dear

This is in reply to the private letter ruling request in which the Taxpayer, has requested to revoke an election under § 108(b) (5) of the Internal Revenue Code.

Facts

On Date 2, Date 3, and Date 4, the taxpayer, a C corporation, repurchased its own publicly traded notes in the open market with a face value totaling $ X2. These notes were originally purchased for consideration of $ X3. As a result, the Taxpayer during Date 1 realized cancellation of indebtedness income gain in the total amount of $ X1.

The Taxpayer's liabilities exceeded the fair market value of its assets by approximately $ X4, $ X5 and $ X6, immediately before the repurchase of the notes at Date 2, Date 3, and Date 4, respectfully, causing the Taxpayer to be insolvent as defined in § 108(d)(3). After the repurchase, the Taxpayer remained insolvent as the level of debt exceeded assets at that time.

The Taxpayer retained Representative to prepare its Date 7 federal income tax return. Representative advised the Taxpayer that if the amount of its insolvency was greater than the gains realized from the debt repurchase, that the gain would not be includible in taxable income under § 108. Moreover, there also would be no reduction in the tax attributes of the Taxpayer, that is, reduction in basis of its assets, as a result of the exclusion of the gain from gross income because of the limitations contained in § 1017(b)(2). Due to this nonreduction of basis attribute, there was no need to make a § 108(b)(5) election. Accordingly, the decision was made not to make an election under § 108(b)(5) to reduce the basis of the Taxpayer's property.

During Date 5, Representative prepared the return for Date 6 taxable year, and the Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness, for the discharge of indebtedness. Part I was properly prepared showing the amount of discharge and that the discharge was excludible because of the insolvency exception. However, the preparer inadvertently placed the discharged amount on line 5 of the form. It was not realized that the entering of an amount on that line served to make an

election under § 108(b)(5). The Taxpayer reviewed the return and, not being familiar with Form 982, believed the return was prepared properly to reflect its intended tax treatment.

When filing the Date 7 year tax return, neither Representative nor the Taxpayer believed that an election under § 108(b)(5) had been made. They knew that the analysis of the transaction contemplated no such election. Further, no reduction in property basis was ever made as it would have been had an election been intended. The Taxpayer's quarterly estimated tax payments for the year Date 8 are consistent with not making an election under § 108(b)(5) because the depreciation amount used in the computation was based on the Taxpayer's historical tax depreciation basis. In addition, the Taxpayer's quarterly and year end financial statements filed with the Securities and Exchange Commission are also consistent with no § 108(b)(5) election having been made because tax depreciation is calculated using the Taxpayer's historical tax basis, unadjusted for any basis reduction.

On or about Date 9, during the preparation of the Taxpayer's return for the period ending Date 8, the prior year's return was reviewed and it was discovered that inadvertently a § 108(b)(5) election had been made with the Date 6 return by completing line 5 of Form 982.

An affidavit submitted by the taxpayer and its Representative confirms the above described facts pertaining to the inadvertent election of § 108(b)(5).

Law and Analysis

Section 108(a)(1)(B) provides that gross income does not include an amount that would be includible in gross income by reason of the discharge of indebtedness of the taxpayer if the discharge occurs when the taxpayer is insolvent.

Section 108(b)(1) provides that the amount excluded from gross income shall be applied to reduce certain tax attributes of the taxpayer. Section 108(b)(2) provides, in general, that the reduction shall be made to tax attributes in the following order: (A) net operating losses, (B) general business credits, (C) minimum tax credits, (D) net capital losses and capital loss carryovers, (E) basis of property, (F) passive activity losses, and (G) foreign tax credit carryovers. Section 108(b)(5) states that the taxpayer may elect to apply any portion of the amount excluded from income to the reduction under § 1017 of the basis of the depreciable property of the taxpayer.

Section 1017(b)(2) provides, in general, that in the event of exclusion from income of discharge of indebtedness income by an insolvent taxpayer under §108(a)(1)(B), the reduction in basis of property shall not exceed the excess of the total basis of property held by the taxpayer over the taxpayer's total liabilities. However, this limitation does not apply to any reduction in basis by reason of an election under § 108(b)(5).

Section 1.108-4(b) of the Income Tax Regulations provides that an election under § 108(b)(5) may be revoked only with the consent of the Commissioner.

Taxpayer represents that due to an error an election under §108(b)(5) was made by completing line 5 of Form 982. It was not realized that the entering of an amount on that line served to make an election under § 108(b)(5). This situation is analogous to situations in which taxpayers seek extensions of time under § 301.9100-3 in which to make elections after failing to do so because after exercising reasonable diligence the taxpayer was unaware of the necessity for the election or the taxpayer relied on a qualified tax professional who failed to advise the taxpayer to make the election.

Section 301.9100-3 provides that requests for extensions of time for regulatory elections will be granted when the taxpayer provides the evidence 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 it 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 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.

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 could be imposed under § 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.

The application of factors similar to those above is appropriate to determine whether a taxpayer may revoke an election made under § 108(b)(5). See Rev. Rul. 83-74, 1983-1 C.B. 112, which determined that a homeowner's association should be permitted to revoke an election made under § 528. In the revenue ruling the taxpayer relied on the advice of a professional tax advisor to prepare its returns, acted promptly and diligently to retain another professional tax advisor to review the first advisor's work, and did not take any action inconsistent with its intent to file a proper federal tax return.

Similar to taxpayers seeking relief under § 301.9100-3(b)(1), Taxpayer has relied on a qualified tax professional to prepare its tax return, make the correct elections and not make an election that was not advantageous to it. All actions by the Taxpayer subsequent to entering the discharge amount on line 5 of the Form 982 were consistent with Taxpayer not being aware of and not intending to make the § 108(b)(5) election. Further, the circumstances described by Taxpayer and Representative do not demonstrate any use of hindsight in requesting relief.

Conclusion

Taxpayer is granted 30 days from the date of this letter in which to revoke the § 108(b)(5) election. The revocation should be made in a written statement filed with taxpayer's amended return. A copy of this letter should be attached.

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

J. Charles Strickland
Senior Technician Reviewer
Office of Associate Chief Counsel
(Income Tax & Accounting)