**Internal Revenue Service**

Department of the Treasury
Washington, DC 20224

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October 27, 2010

Attn:

Legend:

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|---|---|
| Taxpayer | = |
| Y | = |
| Z | = |
| Date 1 | = |
| Date 2 | = |
| Date 3 | = |
| Date 4 | = |
| Date 5 | = |
| Preparer 1 | = |
| Preparer 2 | = |
| Preparer 3 | = |
| State | = |

Dear :

This letter responds to a letter dated May 11, 2010, submitted by Taxpayer requesting an extension of time under § 301.9100-3 of the Procedure and Administration Regulations to make an election under section 266 of the Internal Revenue Code to capitalize interest.

FACTS

Taxpayer is a limited liability company organized under the laws of State. Taxpayer is treated as a partnership for federal income tax purposes. All of the outstanding partnership interests of Taxpayer are owned, directly or indirectly, by individual taxpayers Y and Z.

In the taxable year ending Date 1, Taxpayer incurred interest expense ("Interest Expense") on debt that was incurred to acquire real property. As of Date 1, this property was unimproved and unproductive, and no development activities had taken place. Taxpayer deducted the amount of the Interest Expense under section 163(a) on its federal income tax return for the taxable year ending Date 1. This tax return was prepared by Preparer 1, and was filed on or about Date 3.

Y and Z each took into account their allocable share of Taxpayer's items of income, gain, loss, deduction, and credit, including Interest Expense, in their federal income tax returns for the taxable year ending Date 1. Y's tax return was prepared by Preparer 2. Z's tax return was prepared by Preparer 3. Y and Z's federal income tax returns for the taxable year ending Date 1 were filed in Date 4.

In Date 2, the property was foreclosed upon. Taxpayer recognized a gain on the foreclosure because the amount owed the lender exceeded Taxpayer's basis in the land. Preparer 1 was advised of the foreclosure prior to Date 3.

Y and Z's tax returns were prepared by Preparer 2 and Preparer 3, respectively, who did not advise Y and Z that Taxpayer could make an election under section 266 to capitalize the Interest Expense. Preparer 1 did not consider making the election under section 266 to capitalize the Interest Expense because it would not have changed Taxpayer's tax liability. Because Y and Z's personal income tax situations had no effect on the preparation of Taxpayer's income tax return, Preparer 2 and Preparer 3 did not determine whether capitalization of the Interest Expense would be beneficial to Y and Z. In Date 5, Preparer 2 discovered that a significant tax benefit would arise in that taxable year if an election to capitalize the Interest Expense had been made for the taxable year ending Date 1.

Taxpayer represents that Taxpayer, Y, and Z each relied on its respective tax return preparer to advise it regarding any elections that should have been made in computing

taxable income on its respective return for the taxable year ending Date 1. Further, taking into consideration only facts that were known at the time Taxpayer filed its federal income tax return for the taxable year ending Date 1, had Taxpayer, Y, and Z been advised of the election under section 266 and the related tax consequences, Taxpayer would have made the election under section 266 to capitalize the Interest Expense on its tax return for the taxable year ending Date 1. No facts have changed since the due date for making the election that would make the election advantageous to Taxpayer.

## RULING REQUESTED

Taxpayer requests, for the taxable year ended Date 1, an extension of time pursuant to § 301.9100-3 of the Procedure and Administration Regulations to file an election under section 266 to capitalize the Interest Expense as an addition to the cost basis of the real property.

## LAW AND ANALYSIS

Section 266 of the Code provides that no deduction shall be allowed for amounts paid or accrued for such taxes and carrying charges as, under the regulations prescribed by the Secretary, are chargeable to capital account with respect to property, if the taxpayer elects, in accordance with such regulations, to treat such taxes or charges as so chargeable.

Section 1.266-1(a)(1) of the Income Tax Regulations provides that in accordance with section 266 of the Code, items enumerated in § 1.266-1(b) may be capitalized at the election of the taxpayer. Thus, taxes and carrying charges with respect to property of the type described in § 1.266-1 are chargeable to capital account at the election of the taxpayer, notwithstanding that they are otherwise expressly deductible under provisions of Subtitle A of the Code. No deduction is allowable for any items so treated.

Section 1.266-1(b)(1)(i) of the regulations provides that the taxpayer may elect, as provided in § 1.266-1(c), to treat as chargeable to capital account either as a component of original cost or other basis, for the purposes of section 1012 of the Code, or as an adjustment to basis, for the purpose of section 1016(a)(1), in the case of unimproved and unproductive real property: annual taxes, interest on a mortgage, and other carrying charges.

Section 1.266-1(c)(2)(i) of the regulations provides that an election with respect to an item described in § 1.266-1(b)(1)(i) is effective only for the year in which it is made.

Section 1.266-1(c)(3) of the regulations provides that if the taxpayer elects to capitalize an item or items under section 266 of the Code, such an election shall be exercised by filing with the original return for the year in which the election is made a statement

indicating the item or items (whether with respect to the same project or different projects) which the taxpayer elects to treat as chargeable to capital account.

Under § 301.9100-1, the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make a regulatory election.

Sections 301.9100-1 through 301.9100-3 provide the standards 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 § 301.9100-2.

Section 301.9100-3(a) provides that requests for relief under § 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.

Section 301.9100-3(b)(1) provides in part that except as provided in paragraphs (b)(3)(i) through (b)(3)(iii), a taxpayer is deemed to have acted reasonably and in good faith if (A) the taxpayer 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 or (B) the taxpayer reasonably relied on a qualified tax professional and the tax professional failed to make, or to advise the taxpayer to make, the election.

Section 301.9100-3(b)(3) 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 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. The Internal Revenue Service will ordinarily not grant relief because of the use of hindsight if specific facts have changed since the due date for making the election that make the election advantageous to the taxpayer. In such a case, the Service will grant relief only when the taxpayer provides strong proof that the taxpayer's decision to seek relief did not involve hindsight.

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).

Taxpayer has shown that it acted reasonably and in good faith. Further, Taxpayer has shown that the interests of the Government are not prejudiced by granting the requested relief for an extension of time under § 301.9100-1(c).

## CONCLUSIONS

Based solely on the facts and the representations submitted, we conclude that the requirements of §§ 301.9100-1 and 301.9100-3 of the regulations have been met. Accordingly, Taxpayer is granted 60 calendar days from the date of this letter to file the election to capitalize the Interest Expense to the real property under section 266 of the Code with the IRS national office for the taxable year ended Date 1.

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.

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 representative.

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.

The rulings contained in this letter are based upon information and representations submitted by the 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.

Sincerely,

W. Thomas McElroy, Jr.
Senior Technician Reviewer, Branch 6
(Income Tax & Accounting)