Internal Revenue Service

Department of the Treasury
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Legend

Trust =

Year 1 =

Year 2=

Firm =

Date 1 =

$a =

$b =

$c =

$d =

$e =

$f =

Dear :

This is in response to your letter requesting permission to revoke an election made by Trust pursuant to § 1.163(d)-1(c) of the Income Tax Regulations to treat net capital gain

income as investment income under §§ 163(d)(1) and 163(d)(4)(B) of the Internal Revenue Code for Year 1 and Year 2.

FACTS

For Year 1 and Year 2, Trust hired an accounting firm (Firm) to prepare its Form 1041, U.S. Income Tax Return for Estates and Trusts ("Return"). The Firm prepared the Return by entering the relevant data into a tax software computer program ("Software") but a keying error was made on line 4g of Form 4952, *Investment Interest Expense Deduction*, that resulted in an inadvertent election to include the entire amount of qualified dividend income and net capital gain in each year. For Year 1 $a was treated as investment income for purposes of the deduction for investment interest expense. The actual amount of investment interest in Year 1 was $b, an amount significantly less than $a. For Year 2 $c was treated as investment income for purposes of the deduction for investment interest expense. The actual amount of investment interest in Year 1 was $d, an amount significantly less than $c.

In Year 2 Trust also had qualified dividend income that is not included in this ruling request.

The Firm manually reviewed the return in accordance with the Firm's quality control policies and procedures. Because all of the investment interest expense of $b for Year 1 and $d for Year 2 was allowed on the respective Forms 4952, there was an oversight in discovering that an excessive election amount had been made on line 4g of the Forms 4952 which affected the calculation for each year. The Firm uses the Software to prepare many Forms 1040 during filing season. For Forms 1040, the Software automatically limits an election to include qualified dividend income and net capital gain as investment income for purposes of calculating the deduction for investment interest expense to the amount of investment interest. The Firm relied on the software to calculate investment interest expense in the same manner for the taxpayer's Return, however the Software does not do this automatically for a Form 1041. The Firm was unaware of the differences in the computer tax software in identifying this type of error.

The error was discovered by the beneficiary's business manager. The Firm was contacted by the business manager on Date 1 and was advised of the Form 4952 elections.

LAW & ANALYSIS

Section 163(d) provides that, in the case of a taxpayer, other than a corporation, the amount allowed as a deduction for investment interest shall not exceed the net investment income of the taxpayer for the taxable year.

Section 163(d)(4)(B) defines the term, "investment income," in general, as the sum of:

(i) gross income from property held for investment (other than 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 by only 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 163(d)(4)(B) also provides that the term includes qualified dividend income (as defined in § (1)(h)(11)(B)) only to the extent the taxpayer elects to treat such income as investment income for purposes of this subsection.

Section 1.163(d)-1(b) provides that the elections for net capital gain and qualified dividend income under § 163(d)(4)(B) must be made on or before the due date (including extensions) of the income tax return for the taxable year in which net capital gain is recognized or the qualified dividend income is received.

Section 1.163(d)-1(c) provides that the election under § 163(d)(4)(B) is revocable with the consent of the Commissioner.

The Trust is requesting permission to revoke an election to treat net capital gain income as investment income. This situation is analogous to those situations concerning taxpayers who have not made a particular election provided in the regulations because of inadequate or incorrect advice from knowledgeable tax professionals and are subsequently seeking extensions of time under § 9100 of the Regulations on Procedure and Administration. See Rev. Rul. 83-74, 1983-1 C.B. 112.

Section 301.9100-3 generally provides extensions of time for making regulatory elections. For this purpose, § 301.9100-1(b) defines the term "regulatory election" to include an election whose due date is prescribed by a regulation, a revenue ruling, revenue procedure, notice or announcement published in the Internal Revenue Bulletin.

Section 301.9100-3 provides that requests for extensions of time for regulatory elections will be granted when the taxpayer provides evidence (including affidavits described in the regulations) 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 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 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.

In this case, Trust may be considered to have acted reasonably and in good faith because Trust relied on the Firm, a qualified tax professional, to prepare the return. The Firm used a software program that made an erroneous election that was not discovered by the Firm despite reasonable efforts.

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 has been or could be imposed under § 6662 at the time the taxpayer requests relief (taking into account any qualified amended return filed within the meaning of § 1.6664-2(c)(3)) and the new position requires 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. If specific facts have changed since the original deadline that make the election advantageous to a taxpayer, the Service will not ordinarily grant relief.

In this case, Trust is not seeking to alter a return position for which an accuracy-related penalty has been or could be imposed under § 6662 at the time relief is requested. Trust was not informed in all material respects of the related tax consequences of making the election because Trust was unaware an election had been made. Furthermore, Trust is not using hindsight in requesting relief. Specific facts have not changed since the filing of the return and making of the original election that made the election disadvantageous to the Trust.

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).

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 timely made, are closed by the period of limitations on assessment. Under these criteria, the interests of the government are not prejudiced in this case. Allowing the revocation of the election would not result in a lower tax liability in the aggregate for all taxable years affected by the election than would have been the case if the election had been timely made (taking into account the time value of money). Furthermore, when the request was filed, the taxable year in which the regulatory election that is sought to be revoked here, and any taxable year affected by it, was not closed by the period of limitations on assessment.

In addition, granting the revocation in the present situation would not cause undue administrative burden, nor would it be inconsistent with the objectives of the underlying statute and the regulatory election.

CONCLUSIONS

The consent of the Commissioner is hereby granted to revoke, in part, the election under § 163(d)(4)(B) to include $a as investment income for Year 1 and to include only amount $e as investment income for Year 1.

The consent of the Commissioner is hereby granted to revoke, in part, the election under § 163(d)(4)(B) to include $c as investment income for Year 1 and to include only amount $f as investment income for Year 2.

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.

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

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.

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.
In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

John P. Moriarty
Chief, Branch 1
(Income Tax & Accounting)