

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:
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Legend

Taxpayer =
TIN:
Year 1 =
Year 2 =
\$X =
\$Y =
Date 1 =
Date 2 =

Dear :

This is in reference to an election that Taxpayer made to reduce the basis of depreciable property under section 108(b)(5) of the Internal Revenue Code by the amount excluded from income under section 108(a)(1)(B). Taxpayer is requesting permission to revoke that election pursuant to section 1.108-4(b) of the Income Tax Regulations.

Taxpayer is a self-employed real estate professional. In Year 1, Taxpayer owned three residential apartment buildings. Taxpayer had \$X cancellation of indebtedness in and had \$Y net operating losses (NOLs). Taxpayer represents that it was insolvent in Year 1.

Taxpayer filed an original Year 1 Federal income tax return to reduce tax attributes in the order under section 108(b)(2). Upon the advice of an established mid-sized CPA firm, Taxpayer filed an amended Federal income tax return and elected to first reduce basis against depreciable property under section 108(b)(5) to preserve its NOLs. This amended return was a request under section 301.9100-2 of the Procedure and Administration Regulations.

Taxpayer sold one of its properties in Year 2. Taxpayer's current representative has informed this office that Taxpayer sold this property at a gain. Taxpayer indicates in its supplemental submission that much of its income in Year 2 was a result of the sale of the property with the reduced basis as a result of the election under 108(b)(5).

Law and Analysis

Section 61(a)(12) provides that gross income includes income from discharge of indebtedness.

Section 108(a)(1)(B) provides that gross income does not include any 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 section 1017 of the basis of the depreciable property of the taxpayer. Section 108(b)(5)(B) provides that the basis reduction shall not exceed the aggregate bases of the depreciable property held by the taxpayer as of the beginning of the taxable year following the taxable year of the discharge. Section 108(b)(5)(C) provides that the tax attributes under section 108(b)(2) are not reduced if a taxpayer makes an election under section 108(b)(5).

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 section 108(a)(1)(B), the reduction in basis of property shall not exceed the excess of the total bases of property held by the taxpayer immediately after the discharge over the taxpayer's total liabilities immediately after the discharge. However, this limitation does not apply to any reduction in basis by reason of an election under section 108(b)(5). In this situation, there would be no basis reduction limitation.

In the present case, Taxpayer engaged a qualified tax professional to amend its Year 1 Federal income tax return. Taxpayer submitted only one affidavit describing the engagement from the tax professional engaged to amend its Year 1 Federal income tax return. In that affidavit, the tax professional states, under penalties of perjury, that he discussed the tax attribute reduction ordering rules under section 108(b)(2) and the election under section 108(b)(5) to first reduce basis against depreciable property. In the affidavit, the tax professional further states that, after numerous discussions, the decision was made to utilize the election under section 108(b)(5) to preserve the NOLs.

Taxpayer asserts that, on Date 1, it became aware that it was not properly advised by the tax professional about the effect of making the election under section 108(b)(5) by an insolvent taxpayer. Some 17 months later, Taxpayer requested permission to revoke that election pursuant to section 1.108-4(b) on Date 2.

Based on the information submitted, Taxpayer is not granted permission to revoke its late section 108(b)(5) election made under section 301.9100-2 of the Procedure and Administration Regulations. First, the sole affidavit prepared by Taxpayer's tax preparer states, under penalties of perjury, that he and Taxpayer had numerous conversations about the tax attribute reduction ordering rules under section 108(b) and the section 108(b)(5) election, and that Taxpayer, a real estate professional, decided to make the election in order to preserve its NOLs. Taxpayer's statements to the contrary do not overcome the statements made by the tax professional that Taxpayer made a deliberate decision to preserve its NOLs. Second, to allow Taxpayer to revoke its section 108(b)(5) election would prejudice the interests of the government in that Taxpayer would have a lower tax liability for all tax years (including by reducing, or eliminating, any gain on sale of property in Year 2). Lastly, Taxpayer did not act diligently and in good faith by waiting 17 months to request permission to revoke the election. Therefore, permission to revoke the election under section 108(b)(5) is not granted.

Caveats

Except as expressly provided, we express no opinion 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 taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

The ruling contained in this letter is based upon information and representations submitted by the taxpayers and accompanied by a penalty of perjury statement executed by the taxpayers. While this office has not verified any of the material submitted in support of the request for a ruling, it is subject to verification on examination.

Sincerely,

Donna Welsh
Senior Technician Reviewer
Office of Associate Chief Counsel
(Income Tax & Accounting)