INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM
June 17, 1999

Number: **199937020**
Release Date: 9/17/1999
Index (UIL) No.: Sec. 172.01-00
CASE MIS No.: TAM-122225-98

District Director

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Years Involved:
Date of Conference:

LEGEND:

Taxpayer=
Year 1=
Year 2=
Year 3=
Year 4=
Year 5=
Year 6=
Year 7=
$A=
$B=

ISSUES:

(1) Whether an election made by Taxpayer under section 172(b)(3)(C)[1] of the Internal Revenue Code to relinquish the carryback period with respect to a net operating loss may be disregarded based on a material mistake of fact.

(2) Whether Taxpayer's election under section 172(b)(3)(C) is technically defective.

CONCLUSION:

---

[1] Unless provided otherwise, all section references refer to sections of the Internal Revenue Code as in effect for the appropriate tax year or years under discussion.

(1) Section 172(b)(3)(C) unequivocally states that the election to forego the carryback period with respect to net operating losses is irrevocable. Additionally, Taxpayer cannot disregard the election based on a material mistake of fact.

(2) The election made by Taxpayer correctly identified section 172(b)(3)(C) and thus, is not technically defective.

FACTS:

Taxpayer reported a net operating loss on its consolidated federal income tax return for Year 4 ("Year 4 Return"). On the Year 4 Return, Taxpayer included a statement electing under section 172(b)(3)(C) of the Code to forego the carryback of the NOL incurred for such year. Taxpayer indicated that the economic circumstances of Taxpayer at the time of filing the Year 4 Return warranted making the election to forego the NOL carryback. The statement attached to Taxpayer's Year 4 Return stated that Taxpayer elected "to forego the carryback period with respect to the net operating loss generated in [Year 4]" in accordance with "Regulation Section 172(b)(3)(c)". The NOL was carried forward to and utilized in Year 6.

Had Taxpayer not elected under section 172(b)(3)(C) to forgo the NOL carryback period, this increased Year 4 NOL would be carried back and used to offset Taxpayer's income for Year 3, as increased by the Service's disallowance of losses. Taxpayer now seeks to disregard its election under section 172(b)(3)(C) to forego the carryback period for the Year 4 NOL.

LAW AND ANALYSIS:

ISSUE 1

Section 172(a) provides that a deduction shall be allowed for the taxable year for an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year.

Section 172(b)(1) for the years at issue provides generally that a net operating loss for any taxable year (A) shall be a net operating loss carryback to each of the 3 taxable years preceding the taxable year of such loss, and (B) shall be a net operating loss carryover to each of the 15 taxable years following the taxable year of the loss.

Section 172(b)(3)(C) provides that a taxpayer entitled to a carryback under section 172(b)(1) may elect to relinquish the entire carryback period with respect to a net operating loss for any taxable year ending after December 31, 1975. In addition, section 172(b)(3)(C) provides that such an election, once made for any taxable year, shall be irrevocable for such taxable year.

In Meyer's Estate v. Comm'r, 200 F.2d 592 (5th Cir. 1952), the court addressed the issue of whether a taxpayer may abandon a valid election on the ground of a material mistake of fact. Under section 115(c) (the predecessor to section 333 of the Internal Revenue Code of 1954), owners of a corporation adopting a plan of liquidation would recognize the gain on the liquidation as a capital gain. However, owners of more than 80% of the corporation's voting stock could elect to have any gain on liquidation taxed under the alternative method provided in then-section 112(b)(7). Treasury Regulation section 29.112(b)(7)-2 provided that such an election was irrevocable.

Based on the earned surplus figure which appeared on the corporate books as prepared by a third party, the taxpayers in Meyer's Estate made the election for their respective share of the earned surplus to be taxed as ordinary income under section 112(b)(7). However, after an audit of the taxpayers' returns, the Commissioner determined that the true earned surplus of the corporation had been significantly understated. The taxpayers argued that the election should be rescinded because it was based on a material mistake of fact, i.e. reliance on the wrong earned surplus figure which was provided by an unrelated tax preparer. The court found a stipulation between the taxpayer and the Service that the taxpayer had relied on an incorrect earned surplus amount on the corporate records crucial to its decision to allow the taxpayer to abandon its election based on a material mistake of fact.

In M. Lane Powers v. Comm'r, T.C. Memo. 1986-494, the taxpayer argued that a mistake of fact warranted revocation of a section 172(b)(3)(C) election. The taxpayer argued that the factual mistakes were the correctness of certain items found on the tax returns (e.g., whether certain deductions should have been claimed), thus causing the net income to be higher on prior years' returns. The court held that the taxpayer was attempting to revoke an election because a subsequent audit by the Commissioner revealed mistakes in the tax treatment of certain items. The court stated that if the taxpayer were allowed to revoke an election under section 172(b)(3)(C) then the

"irrevocability of the election is called into question." In addition, the court stressed that the statute, by requiring an irrevocable election, does not allow the taxpayer to "wait and see" whether the election is profitable.

In Young v. Comm'r, 783 F.2d 1201 (5th Cir. 1986), the court addressed the legislative history of section 172(b)(3)(C) in holding that the taxpayer did not substantially comply with the requirements of section 172(b)(3)(C). The court stated that the legislative history "plainly indicates that the election requirement is of the essence of the statute." The statutory intent was to require the taxpayer to assume the risk when making the election that a carryback would later prove preferable.

The plain language of section 172(b)(3)(C) requires that while a taxpayer is entitled to forego the carryback period with respect to net operating losses, such an election is *irrevocable*. Thus, the statute makes clear the legislative intent that the Service has no discretion to allow Taxpayer to revoke a section 172(b)(3)(C) election.

In addition to the plain language of the statute and the clear legislative intent that the election be irrevocable, this case is also distinguishable from Meyer's Estate. Here there is no stipulation between Taxpayer and the Service that Taxpayer did in fact rely on a material mistake of fact in making the section 172(b)(3)(C) election. In no case after Meyer's Estate has a taxpayer's argument to revoke an irrevocable election prevailed. Specifically, no valid section 172(b)(3)(C) election has been disregarded based upon a material mistake of fact. Courts have consistently held that the taxpayers' claims of material mistakes of fact are in reality mistakes of law. In Carlstedt Associates, Inc. v. Comm'r, T.C. Memo. 1989-27, the taxpayer sought to revoke an election under section 172(b)(3)(C) based on a mistaken belief as to the amount of operating losses. The court determined that the taxpayer misapplied the law to a fixed set of facts which caused it to misjudge the extent of its operating losses. The court distinguished Meyer's Estate on the ground that the decision was based "almost entirely on a stipulation by the parties" that the taxpayer had relied on a mistake of fact.

In Bankers & Farmers Life Insurance Co. v. U.S., 643 F.2d 234 (5th Cir. 1981), the Service disallowed an operating loss carryforward. The taxpayers had relied on corporate books and records in making an election under section 815(d)(1). The Fifth Circuit, noting there was no stipulation between the IRS and the taxpayer, found the election to be based on a mistake of law. Thus, the taxpayer was not entitled to revoke the election. In Peter A. Johnson and Claire P. Lyon v. Comm'r, T.C. Memo. 1991-645, the taxpayer made an election under section 333. The court disallowed revocation of the election. The court noted that of critical importance was the fact that there was no stipulation between the Service and the taxpayer as to any mistake of fact. Furthermore, the Tax Court stressed that it had "never agreed with the reasoning in Meyer's Estate."

While Meyer's Estate provides limited footing for disregarding an irrevocable election which is based upon a material mistake of fact, it is inapplicable to Taxpayer. It is of critical importance in this case, like the cases subsequent to Meyer's Estate, that there is no stipulation between Taxpayer and the Service that Taxpayer's section 172(b)(3)(C) election was based on a material mistake of fact. Thus, Taxpayer may not disregard its election under section 172(b)(3)(C) to forego an NOL carryback period.

ISSUE 2

Section 172(b)(3)(C) provides that an election under section 172(b)(3)(C) shall be made in the manner prescribed by the Secretary and shall be made by the due date (including extensions of time) for filing the taxpayer's return for the taxable year of the net operating loss for which the election is to be in effect.

Section 301.9100-12T(d) of the Income Tax Regulations provides the manner for making an election under section 172(b)(3)(C). The Regulation requires the taxpayer to attach a statement to the return indicating the section under which the election is being made and information to identify the election.

Taxpayer asserts that the statement attached to the Year 4 Return making the election under section 172(b)(3)(C) was technically defective. In Powers v. C.I.R. Service, 43 F.3d 172 (5th Cir. 1995), the taxpayer attached a statement to the federal income tax return electing to carryforward its net operating loss "pursuant to section 56(b)(3)(C)." Section 56 pertains to the alternative minimum tax and not to the net operating loss deduction. The taxpayer argued, and the court agreed, that the election did not indicate the proper section as required by the regulations. The court found "the failure to cite section 172 fatal to the election's validity." The court added that "an election under section 172 must correctly cite section 172."

In Santi v. Commissioner, T.C. Memo 1990-137, the taxpayer referred to section 172(b)(2)(c) in electing to forego the carryback period under section 172(b)(3)(C). The court was convinced that the taxpayer "intended to relinquish the right to carry the loss back to the prior years." Furthermore, the court held that the inaccurate reference made by the taxpayer was "certainly sufficient to alert the Internal Revenue Service to petitioner's intention to carry the net operating loss forward rather than backward." The court found this error to be less significant than the error in Powers. The court also noted that unlike Powers, the taxpayer correctly referenced section 172(b).

In this case, Taxpayer's statement clearly indicated its intent to elect "to forego the carryback period with respect to the net operating loss generated in [Year 4]." While Taxpayer referred to "Regulation Section 172(b)(3)(c)", this does not rise to the level of deficiency found in Powers. Like the taxpayer in Santi, Taxpayer correctly referred to

section 172(b). Here, Taxpayer even correctly referenced section 172(b)(3)(C). The inclusion of "regulation" in Taxpayer's statement is insufficient to find a defective election. The reference to section 172(b)(3)(C) and the language included by Taxpayer sufficiently satisfy the requirements of the regulation. Therefore, Taxpayer's election under section 172(b)(3) cannot be disregarded due to a technical defect.

CAVEAT(S)

A copy of this technical advice memorandum is to be given to Taxpayer. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.