

Index Nos: 9100.00-00, 565.01-02 and 542.00-00

199952091

Internal Revenue Service

Department of the Treasury

P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:IT&A:5 PLR-110678-99

Date: OCT - 1 1999

Taxpayer	=
State X	=
Date 1	=
CorpA	=
<u>X</u>	=
<u>P</u>	=
<u>Q</u>	=
Year 2	=
<u>Y</u>	=
CityW	=
<u>Z</u>	=
\$J	=
Date 3	=
<u>V</u>	=
Blackacre	=
Date 4	=
\$K	=
\$L	=
\$M	=
\$N	=
\$O	=
on Date 5	=
Date 6	=

568

199952091

\$R =
 Whiteacre =
 Bank =
 Date 7 =
 \$S =
 Year 8 =
 Year 9 =
u =
 FirmB =
 Date 10 =
 Date 11 =
 \$T =
 \$U =
 Year 12 =
 Date 13 =
 Agent =
 Representative =
 Date 14 =
 \$V =
 \$W =
 Date 10A =
 Date 11A =

Dear

This responds to your letter of June 9, 1999, and subsequent correspondence, requesting an extension of time, under §§ 301.9100-1 and -3 of the Procedure and Administration Regulations, for Taxpayer and its shareholder to make consent dividend elections pursuant to § 565 of the Internal Revenue Code. We understand the following to be the essential facts for determining whether Taxpayer is entitled to the relief requested.

Taxpayer was incorporated in State X on Date 1, as CorpA. Initially, Taxpayer's business was x. Originally, this business was owned and operated by P and his wife, Q, as an unincorporated business.

In Year 2, P decided to enter the business of owning and managing commercial real estate. Corp A sold the assets of its first business of x and changed its name to Taxpayer. Using the cash proceeds from this sale, Taxpayer purchased land and constructed y industrial buildings in the CityW area. These buildings were subsequently leased to various businesses. Using the cash flow generated by these leases Taxpayer was able to accumulate enough cash to purchase additional properties. Over the years

John

Taxpayer continued to increase its real estate holdings. Currently, Taxpayer owns and manages z buildings located on various properties in the CityW area. These properties generate approximately \$J of income per year.

On Date 3, y damaged one of Taxpayer's properties, a building located at Blackacre. As a result of y, the office structures of the building were destroyed. Taxpayer filed a claim with its insurance provider for the fair value of the damaged property. Taxpayer's claim was satisfied by Date 4 for the total settlement amount of \$K. Taxpayer used part of these proceeds to repair structural damages.

At the time of y, Taxpayer's adjusted basis in the damaged building at Blackacre was \$L. Thus, Taxpayer realized a gain of \$M. However, Taxpayer elected to defer this gain under § 1033 of the Internal Revenue Code. To defer this gain Taxpayer was required to reinvest its insurance proceeds in property similar or related in service or use to the converted property before Date 6. Taxpayer had already used \$N to reconstruct the damaged offices. Therefore, only \$O needed to be reinvested. Taxpayer decided to reinvest these additional proceeds in another building. Within the replacement period (on Date 5), Taxpayer acquired replacement property (a building located at Whiteacre) at a cost of \$R.

During the replacement period, Taxpayer invested the insurance proceeds in certificates of deposit (CDs) issued by Bank. In addition, on Date 7, Taxpayer also invested its existing cash reserves of \$S in other CDs. As a result of these transactions, Taxpayer's interest income suddenly increased to a significantly higher level. In fact, its interest income exceeded 10 percent of Taxpayer's ordinary gross income for the first time in Year 8 and exceeded 11 percent in Year 9. As a consequence of the interest income exceeding the 10 percent level, Taxpayer's tax status changed to that of a personal holding company for those two years.

For more than u years, FirmB has assisted Taxpayer with the compilation and review of its financial statements and the preparation and review of its annual corporate income tax returns. FirmB was not aware of any proposed personal holding company tax assessment made by the Service prior to Taxpayer's most recent audit, nor was FirmB aware of any prior consent dividend election. For taxable years ended Date 10 and Date 11, Taxpayer failed to include Forms 972 and 973 in its federal tax returns. FirmB was not aware of Taxpayer's need to file such forms nor did FirmB inform Taxpayer that the consent dividend election could be made. According to Taxpayer, its shareholders would have agreed to pay the tax on dividend income of \$T and \$U, for the taxable years ended Date 10 and Date 11, respectively, if FirmB had advised it to do so, thus avoiding Taxpayer's classification as a personal holding company.

In Year 12, the Service commenced an examination of Taxpayer's federal

income tax returns for the taxable years ended Date 10 and Date 11. On Date 13, Taxpayer received an Information Document Request from Agent asking Taxpayer to explain why it did not report personal holding company tax liability on its originally filed tax returns. Representative, a partner of FirmB, CityW, responded on behalf of Taxpayer that neither Taxpayer nor FirmB had made a determination of Taxpayer's personal holding company status for the years under examination. However, after receiving notice from the Service, FirmB looked into the issue and discovered that Taxpayer met the definition of a personal holding company because it failed to distribute \$T and \$U in taxable years ended Date 10 and Date 11, respectively. On Date 14, Agent issued Taxpayer a Form 2198, determination of liability for Personal Holding Company Tax, indicating that Taxpayer had a personal holding company tax liability due for Date 10 and Date 11, of \$V and \$W, respectively.

This request for relief concerns Taxpayer's failure to timely file forms 972 and 973 in connection with consent dividends to be allotted to its shareholders to avoid imposition of the personal holding company tax under § 541 of the Internal Revenue Code. The filing date prescribed is not later than the due date of Taxpayer's income tax return for the taxable year for which the dividends paid deduction is claimed. See § 1.565-1(b)(3). Under Rev. Rul. 78-296, 1978-2 C.B. 183, a consent dividend election may be filed with a corporation's return on its extended due date.

For the taxable years ended on Date 10 and Date 11, Taxpayer filed its federal income tax returns on Date 10A and Date 11A respectively. Accordingly, the election filings were due on Date 10A and Date 11A.

The failure to file Forms 972 and 973 for making the consent dividend election was due to the oversight of FirmB. FirmB acknowledges this error by the sworn affidavit of one of its partners, Representative.

Section 301.9100-1(c) of the Procedure and Administration Regulations generally provides that the Commissioner, in his discretion, may grant a reasonable extension of time to make a regulatory election or a statutory election (but no more than six months except in the case of a taxpayer who is abroad) under all subtitles of the Internal Revenue Code except subtitles E, G, H and I.

The regulations under § 301.9100-3 generally provide extensions of time for making regulatory elections. For this purpose, § 301.9100-1 defines the term "regulatory election" to include an election whose deadline is prescribed by a regulation, revenue ruling, revenue procedure, notice or announcement published in the Internal Revenue Bulletin.

Section 301.9100-3(a) of the regulations provides, in part, that requests for relief

will be granted when the taxpayer provides evidence (including affidavits) establishing to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the government.

Section 301.9100-3(b)(1) of the regulations provides, in part, that except as otherwise provided (in paragraphs (b)(3)(i) through (iii) of that section), a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer "(i) Requests relief under this section before failure to make the regulatory election is discovered by the IRS; ... 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 addition, §301.9100-3(b)(2) of the regulations provides that for purposes of this paragraph (b), a taxpayer will not be considered to have reasonably relied on a qualified tax professional if the taxpayer knew or should have known that the professional was not – (i) competent to render advice on the regulatory election; or (ii) aware of all relevant facts.

The affidavits presented in the present case show that Taxpayer acted reasonably and in good faith, having relied entirely on FirmB, an accounting firm, to prepare its returns and advise it on tax matters for more than u years, including the tax years at issue. FirmB is generally regarded within the tax profession as a competent advisor in all tax matters. Furthermore, FirmB admits that it was aware of all relevant facts pertaining to Taxpayer's status as a personal holding company, but simply neglected to take notice of those facts in light of § 541 or take action to protect its client from the consequences of this status.

Section 301.9100-3(b)(3) of the regulations 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 § 6662 at the time the taxpayer requests relief (taking into account § 1.6664-2(c)(3) of this chapter) 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. In connection with hindsight, if specific facts have changed since the due date for making the election that make the election advantageous to the taxpayer, the IRS will not ordinarily grant relief. In such a case, the IRS will grant relief only when the taxpayer provides strong proof that the taxpayer's decision to seek relief did not involve hindsight.

In the present case, Taxpayer is not seeking to alter its return position for which an accuracy-related penalty has been or could be imposed under § 6662. Further,

572

Taxpayer was not informed of the need to make an election under § 565 of the Code and so did not make any conscious choice as to whether or not to make an election. In addition, there is no indication that Taxpayer was using hindsight, as defined above, in requesting this relief. This request for relief was made within a year after the failure to make the election was discovered. Specific facts have not changed since the due date for making the election that make the election more advantageous to Taxpayer.

Section 301.9100-3(c)(1)(i) of the regulations 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) of the regulations provides, in part, that the interests of the government are ordinarily prejudiced if the taxable year in which the regulatory election should have been made, or any taxable years that would have been affected by the election had it been timely made are closed by the period of limitations on assessment.

In the present case, Taxpayer will not have a lower tax liability in the aggregate for any of the years in which the election will apply than the taxpayer would have had if the election had been timely made (taking into account the time value of money). Also, no taxable year that would be affected by the election, had it been timely made, is closed by the period of limitations on assessment.

Taken together, these disclosed circumstances indicate that the omission that Taxpayer now seeks to correct originated from an honest mistake on the part of its tax advisors, and not from a desire to avoid taxes. Since no prejudice to the government is indicated, the Commissioner should grant the requested extension of time to file the appropriate forms necessary to make the § 565 consent dividend election.

Accordingly, the consent of the Commissioner is hereby granted Taxpayer for an extension of time to file the forms necessary to make the § 565 consent dividend election. This extension shall be for a period of 45 days from the date of this ruling. Please attach a copy of this ruling to the returns, schedules and forms filed in connection with making the election under § 565 when such forms are filed.

No opinion is expressed as to the application of any other provision of the Code or the regulations which may be applicable under these facts. This ruling is directed

only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that a private letter ruling may not be used or cited as precedent.

Sincerely yours,

Assistant Chief Counsel
(Income Tax & Accounting)

by David L. Crawford
David L. Crawford, Chief
Branch 5