Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

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Date:
July 20, 2005

LEGEND

Years 1-5	=
Years 2-7	=
Year X	=
t	=
A	=
State	=
u	=
v	=
B	=
e	=
Year 1	=
f	=
Representative	=
Year 4	=
Date 1	=
Year 2	=
Date 2	=
Date 3	=
Date 4	=

Dear

This is in reply to your letter requesting a ruling that you have either made a valid election, or should be granted an extension of time to make an election, under § 108(c)(3)(C) of the Internal Revenue Code to exclude from income discharge of indebtedness income (COD) and reduce basis of depreciable real property as a result of the discharge of qualified real property business indebtedness.

FACTS

You filed joint federal income tax returns for the Years 1-5. The period of limitations on assessment under § 6501 for tax Years 2-7 have expired. In Year X, you acquired a t% investment unit in A, a State limited partnership. A owned a u% profits and loss interest and a v% capital interest in B.

As a consequence of a restructuring of B's indebtedness, it reported $e of COD on its Year 1 Form 1065, Return of Partnership Income. B included this amount on the Schedule K-1 it furnished to A. A reported this $e as COD on its Year 1 Form 1065. A furnished you with a Schedule K-1 separately stating $f as your allocable share of the COD.

Representative, a CPA, prepared your Year 1 federal income tax return and attached a Form 8082, Notice of Inconsistent Position, to the return excluding the $f from income. Representative had determined that use of the Form 8082 was appropriate for two reasons. First, the Schedule K-1 that A sent to you had reported the COD income, which was inconsistent with your exclusion of the COD on your Year 1 return. Second, Representative claims that Year 1 instructions for Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment), suggested that it was not to be used for Year 1 returns.[1] Your Form 8082 included the following statement:

> The K-1 of the partnership above reflected forgiveness of debt. According to the records of the taxpayer, this debt was the debt of the seller, and should have reduced the carrying value of the asset, under section 108(e)(5) and not have been reflected as income. In addition, it is believed that this debt was never included as part of the qualified debt, nad [sic] therefore would have no effect on this taxpayer's return.

You assert that by filing Form 8082 and the attached statement you substantially complied with the requirements of making an election under § 108(c)(3)(C). You have not reduced basis in property, however, as required by § 108(c)(1) and § 1017(b)(3).[2] Instead, you filed the Year 2 income tax return and all subsequent returns by claiming depreciation deductions on property, the basis of which should have been exhausted pursuant to a valid election under § 108(c)(3)(C).

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[1] Representative's claim appears to be erroneous. Form 982 (Rev. December 1993) states, "**Do not** use this version of Form 982 for discharges in tax years beginning after 1993; a new version will be available for these discharges." Form 982 (Rev. December 1994) states, "Caution: Use this version of Form 982 for discharge of indebtedness only after 1993."

[2] Under § 1017(b)(3)(F) the amount excluded from income under § 108(c)(1) must be applied to reduce basis in depreciable real property held by the taxpayer. Under § 1017(b)(3)(C), any interest of a partner in a partnership is treated as depreciable real property to the extent of such partner's proportionate interest in depreciable real property held by the partnership.

Early in Year 4, the Internal Revenue Service commenced an examination of your Year 1 income tax return. In a Date 1 letter, the IRS revenue agent informed Representative that she was disallowing the exclusion from income of the COD. Representative stated that he intended to challenge the disallowance of the exclusion of the COD as part of the audit of the Year 1 return.

On Date 2, the IRS revenue agent issued her revenue agent's report, which included the following statement:

> Under Section 108(d)(6) the partners of [B] must make the election under Section 108()(1)(D) [sic] to exclude the COD income and to reduce the basis of depreciable property of [B]. A Form 982 should be filed with the Year 1 Form 1065 of [A] in order to make that election. The COD income was reported on by [A] on its Schedule K of its Year 1 tax return. The partners of [A] do not make the election to exclude the income.

In his Date 3 letter to the IRS, Representative asserted that you were the proper party to make the § 108(c)(3)(C) election and that you had made that election. Subsequently, the IRS appeals officer disallowed your exclusion of the COD from gross income. In his Date 4 letter, the IRS District Counsel acknowledged that you could have properly made the election, but that he found no evidence that you made any election. Under § 108(d)(6) you (not A) were required to make the § 108(c)(3)(C) election.[3]

RULINGS REQUESTED

You request the following rulings:

1. You timely made an election under § 108(c)(3)(C) by attaching Form 8082, Notice of Inconsistent Position, to your timely filed Year 1 federal income tax return.

2. If you did not timely make the § 108(c)(3)(C) election, the Commissioner will grant you an extension of time to make the election under § 301.9100-3 of the Procedure and Administration Regulations.

LAW AND ANALYSIS

ISSUE 1

Section 108(a)(1)(D) provides that gross income does not include the amount which (but for § 108(a)) would be includible in gross income by reason of the discharge of

[3] Section 108(d)(6) states that in the case of a partnership, § 108(a), (b), (c), and (g) apply at the partner level.

indebtedness of the taxpayer if in the case of a taxpayer other than a C Corporation, the indebtedness discharged is qualified real property indebtedness.[4]

Section 108(c)(1) provides that the amount excluded from income under § 108(a)(1)(D) shall be applied to reduce basis of the depreciable real property of the taxpayer.

Section 108(c)(3) provides that the term "qualified real property business indebtedness" means indebtedness that—

(A) was incurred or assumed by the taxpayer in connection with real property used in a trade or business and is secured by such real property;

(B) was incurred or assumed before January 1, 1993; and

(C) with respect to which such taxpayer makes an election to have § 108(c)(3) apply.

Section 108(d)(6) provides that in the case of a partnership, § 108(a) and (c) apply at the partner level.

Section 108(d)(9)(A) provides that an election under § 108(c)(3)(C) shall be made on the taxpayer's return for the taxable year in which the discharge occurs or at such other times as may be permitted in regulations prescribed by the Secretary.

Section 108(d)(9)(C) provides that an election referred to in § 108(d)(9)(A) shall be made in such manner as the Secretary may by regulations prescribe.

Section 1.108-5 of the Income Tax Regulations, which is effective December 27, 1993, provides that the election to treat indebtedness as qualified real property business indebtedness under § 108(c)(3) is to be made on Form 982 in accordance with that Form and its instructions.

Based on the information submitted and the representation made in the ruling request, we believe that your Form 8082 and accompanying statement did not constitute an effective election under § 108(c)(3)(C) for the following reasons:

1. You used Form 8082 for its intended purpose of informing the IRS that you were reporting COD inconsistently with A's reporting of the COD on its Form 1065 and the Schedules K-1 it issued to its partners, and not for the purpose of making the election under § 108(c)(3)(C).

2. Your statement did not notify the IRS of any election. Instead, your statement asserted that B was required to exclude from income COD it received under § 108(e)(5).

[4] The provisions cited here reflect § 108 as in effect for discharges of indebtedness occurring in Year 1.

3. Your statement also indicated you should not have been treated as the recipients of COD income not due to the elective provision of § 108(c)(3)(C), but because the B debt that was restructured was not part of any qualified debt.

4. You did not reduce the basis of any assets in any post-Year 1 taxable year as required for a valid § 108(c)(3)(C) election. To the contrary, you took an inconsistent position on returns filed in Year 2 and all subsequent years when depreciation deductions were taken on property, the basis of which should have been exhausted pursuant to a valid election under § 108(c)(3)(C).

5. You never filed Form 982, as required by the regulations under § 108 and IRS instructions, to indicate that you were reducing your basis in property.

Thus, your Year 1 income tax return, the Form 8082 and accompanying statement did not express any intent to make a § 108(c)(3)(C) election. Accordingly, we conclude you neither made a valid § 108(c)(3)(C) election nor substantially complied with the election requirements when you filed your Year 1 income tax return.

Issue 2

Section 301.9100-1 provides that § 301.9100-3 provides the standards the Commissioner will use to determine whether to grant an extension of time to make a regulatory election that does not meet the requirements for an automatic extension under § 301.9100-2.

Under § 301.9100-3 requests for relief 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 the grant of relief will not prejudice the interests of the government. See § 301.9100-3(a).

Section 301.9100-3(c)(1) provides that the Commissioner will grant a reasonable extension of time to make a regulatory election only when the interests of the government are not prejudiced by the granting of relief.

Section 301.9100-3(c)(1)(i) provides that the interests of the Government are prejudiced if granting relief would result in a 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 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 under § 6501(a) before the taxpayer's receipt of a ruling granting relief under this section. The IRS may condition a grant of relief on the taxpayer providing the IRS with a statement from an independent

auditor certifying that the interests of the government are not prejudiced under the standards set forth in § 301.9100-3(c)(1)(i).

Thus, under § 301.9100-3 three separate tests must be met for relief to be granted: (i) the taxpayer must have acted reasonably; (ii) the taxpayer must have acted in good faith; and (iii) the grant of relief will not prejudice the interests of the government. Thus, the Commissioner may not grant relief under § 301.9100 if any one of these three tests are not satisfied.

In this case, the government would be prejudiced under § 301.9100-3(c)(1)(i) if we were to grant relief to file a late election because you would have a lower tax liability in the aggregate for all taxable years affected by the election than you would have had if the election had been timely made. You filed returns for taxable Year 2 and all subsequent years taking depreciation deductions on property, the basis of which should have been exhausted had you timely made a § 108(c)(3)(C) election. Taxable Years 2-7 are now closed. Granting relief would permit you to exclude COD in Year 1. However, due to the expiration of the period of limitations the IRS cannot reduce or eliminate the depreciation deductions taken in Years 2-7. Thus, you would have a lower tax liability in the aggregate for all taxable years affected by the election than if you had made a timely election.

Section 301.9100-3(c)(1)(ii) contemplates that the interests of the Government might not be prejudiced where closed years are involved. However, those situations would appear to be where the amount of tax the taxpayers would pay if relief were granted to make a late election would be the same as if the election were made timely. That is not the case here. The interests of the government would be prejudiced because your depreciation deductions for the closed years (Years 2-7) are higher than they would have been if you had made a timely election and reduced your basis as required by § 108(c)(1). Thus, you do not qualify for relief under § 301.9100-3(c)(1)(ii). Based on the above analysis, it is not necessary to address whether you would fail or meet the other tests to qualify for relief under § 301.9100-3.

You assert that it would be an abuse of discretion to deny an extension of time to make the § 108(c)(3)(C) election. You assert that you would have filed an amended return reflecting a § 108(c)(3)(C) election, but were prevented from doing so because an IRS representative(s) informed you that you were not the proper party to make the election.

We disagree. You did not rely on the statements of any IRS representative to your detriment for several reasons. First, your tax advisor, Representative, consistently maintained that you were the proper party to make the § 108(c)(3)(C) election. For example, Representative represents that he intended to challenge the disallowance of the election as part of the audit of the Year 1 return. Second, there is nothing to indicate that the IRS prevented you from filing an amended return with a late § 108(c)(3)(C) election. Third, during the period that the Year 1 return was under exam, you could have requested a ruling from the National Office of the IRS requesting that a

late filed § 108(c)(3)(C) election be considered timely filed under former § 301.9100-1T of the temporary regulations. *See* section 5.02 of Rev. Proc. 1997-1 C.B. 433, 442. It would not have been necessary for such a ruling to address whether you were the proper party to make the election. See § 301.9100-1(a), which provides that the granting of an extension of time to make an election is not a determination that a taxpayer is otherwise eligible to make an election.[5] Fourth, you did not reduce the basis of any assets in any post-Year 1 taxable year as required for a valid § 108(c)(3)(C) election. To the contrary, you took an inconsistent position on returns filed in Year 2 and all subsequent years by taking depreciation deductions on property, the basis of which should have been exhausted pursuant to a valid election under § 108(c)(3)(C). We also note that under § 301.9100-3, it does not appear that prejudice to the government can be overcome by detrimental reliance on statements by an IRS representative. As noted, above, however, the IRS was not the cause of your failing to file an amended return with a late § 108(c)(3)(C) election within the period of limitations under § 6501.

CONCLUSIONS

1. You did not timely make the § 108(c)(3)(C) election by attaching Form 8082 to your timely filed Year 1 federal income tax return.

2. You are not permitted an extension of time under § 301.9100-3 to make the § 108(c)(3)(C) election because to do so would prejudice the interests of the government.

CAVEATS

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. Enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110.

[5] Former § 301.9100-1T(d), the predecessor of § 301.9100-1(a), contained a similar provision.

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,

Michael J. Montemurro
Acting Branch Chief
Office of Associate Chief Counsel
(Income Tax and Accounting)