Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

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CC:ITA::4/PLR-124614-01
Date:
December 6, 2001

Legend

Taxpayer =

x =

Date =

Dear :

This is in reply to the private letter ruling request in which Taxpayer requests permission to change an election it made under § 108(b)(5) of the Internal Revenue Code.

Facts

Taxpayer, an S corporation, realized cancellation of indebtedness income in the amount of $3.1x[1] on Date. Taxpayer's liabilities exceeded its assets by more than $3.1x immediately before the discharge. Therefore, Taxpayer excluded the entire amount of the cancellation of indebtedness income under § 108(a)(1)(B). On Form 982, which was filed with its income tax return for the tax year that included Date, Taxpayer elected to reduce the basis of its depreciable property by $3.1x as permitted by § 108(b)(5) and §301.9100-13T of the Procedure and Administration Regulations rather than reducing its net operating losses (NOL). The reduction made by Taxpayer is commonly referred to as an "attribute reduction."

Several months after the return was filed, the Supreme Court of the United States decided Gitlitz v. Commissioner, 531 U.S. 206 (2001). Gitlitz holds that an insolvent S corporation's discharge of indebtedness income that is excluded from gross income under § 108(a) is an item of income passed through to the shareholders. The bases of shareholders' stock in the corporation are increased by the excluded income, followed by a reduction under § 108(b) of the corporation's tax attributes.

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[1]All dollar amounts are approximate.

Taxpayer has represented that if the law as decided in the Gitlitz decision had been clear at the time Taxpayer made the election, it would not have made the election. The request considered in this letter was filed less than 2 months after Gitlitz was decided.

Law and Analysis

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 § 1017 of the basis of the depreciable property of the taxpayer.

Section 108(d)(7)(B) states that for an S corporation, for purposes of § 108(b)(2)(A), any loss or deduction disallowed for the taxable year of the discharge under § 1366(d)(1) shall be treated as a net operating loss for such taxable year.

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 § 108(a)(1)(B), the reduction in basis of property shall not exceed the excess of the total basis of property held by the taxpayer over the taxpayer's total liabilities. However, this limitation does not apply to any reduction in basis by reason of an election under § 108(b)(5).

Section 301.9100-13T(e) provides that an election under § 108(b)(5) may be revoked only with the consent of the Commissioner. Section 301.9100-13T is generally effective for discharges of indebtedness occurring after December 31, 1980, and before October 22, 1998.

Taxpayer represents that it made an election under § 108(b)(5) because it was unsure of the law in this area. This situation is analogous to situations in which taxpayers seek extensions of time under § 301.9100-1 in which to make elections after failing to do so because after exercising reasonable diligence the taxpayer is unaware of the necessity for the election or the taxpayer relied on a qualified tax professional who failed to advise the taxpayer to make the election.

Section 301.9100-3 provides that requests for extensions of time for regulatory elections will be granted when the taxpayer provides evidence to establish 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) inadvertently 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.

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 could be imposed under § 6662 at the time the taxpayer requests relief and the new position requires a regulatory election for which relief is requested;
> (ii) was fully informed 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.

The application of factors similar to those above is appropriate to determine whether a taxpayer may revoke an election made under § 108(b)(5). See Rev. Rul. 83-74, 1983-1 C.B. 112, which determined that a homeowner's association should be permitted to revoke an election made under § 528. In the revenue ruling the taxpayer relied on the advice of a professional tax advisor in making the election, showed due diligence by selecting the advisor to prepare its returns, acted promptly and diligently to retain another professional tax advisor to review the first advisor's work, and promptly filed a request to revoke the election.

Similar to taxpayers seeking relief under § 301.9100-3(b)(1), Taxpayer made the election because, after exercising due diligence, it was unaware because of the lack of clarity in the law before the Gitlitz decision, that the election was not advantageous to it. Factors similar to those described in §301.9100-3(b)(3) and 301.9100-3(c) do not apply here.

Conclusion

Taxpayer is granted 30 days from the date of this letter in which to revoke the § 108(b)(5) election. The revocation should be made in a written statement filed with Taxpayer's amended return. A copy of this letter should be attached.

Caveats

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any item discussed or referenced in this letter. This ruling is directly only to the taxpayer requesting it. Section 6110(k)(3) 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.

Sincerely,
Robert A. Berkovsky
Branch Chief
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosure