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Tax Controversy Corner

A Second Chance to Get it Right: Section 9100 Relief for Missed Elections

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A taxpayer who fails to make a timely election may be able to get a second chance from the IRS. The rules for extensions of time for elections are found at Reg. §§301.9100-1 through -3 and apply to many kinds of elections, including an application for relief in respect of tax, or a request to adopt, change or retain an accounting method or accounting period.[1] A grant of Section 9100 relief only forgives the late filing of the election and is not a determination that the taxpayer is otherwise eligible to make the election.

Recognizing the distinction between regulatory and statutory elections is the first step in understanding when and how late-filed elections will be permitted. A regulatory election is an election whose due date is prescribed by regulation or other published guidance, and a statutory election is one in which the due date is prescribed by statute.[2]

Automatic Extensions Under Reg. §301. 9100-2

For specified regulatory elections, there is an automatic extension of 12 months, and for other specified regulatory and statutory elections, there is an automatic extension of six months. Neither the six-month nor the 12-month automatic extension is available where alternative relief is provided by a statute, regulation or other published guidance.[3] In order to be eligible for either the 12-month or six-month extension, the taxpayer must take "corrective action."[4] "Corrective action" means taking the steps required to file the election in accordance with the relevant statute or published guidance.

If the election is required to be filed with a return, corrective action includes filing an original or an amended return for the year in which the election should have been made and attaching the appropriate form or statement for making the election.[5] In addition, the return or statement of election or other filing must state at the top of the document: "FILED PURSUANT TO § 301.9100-2."[6] The taxpayer also must file its returns in a manner consistent with the election and comply with all other requirements for making the election for the year of the election and any other affected years.[7] The 12-month extension is available regardless of whether the taxpayer timely filed its return for the year for which the election should have been made.[8]

The nine regulatory elections currently eligible for the automatic 12-month extension are:

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i. the election to use other than the required tax year under Code Sec. 444;
ii. the election to use the last-in, first out (LIFO) inventory method under Code Sec. 471;
iii. the 15-month rule for filing an exemption application for a Code Sec. 501(c)(9), 501(c)(17) or 501(c)(20) organization under Code Sec. 505;
iv. the 15-month rule for filing an exemption application for a Code Sec. 501(c)(3) organization under Code Sec. 528;
v. the election to be treated as a homeowners association under Code Sec. 528;
vi. the election to adjust basis on partnership transfers and distributions under Code Sec. 754;
vii. the estate tax election to specially value qualified real property (where the IRS has not yet begun an examination of the filed return) under Code Sec. 2032A(d)(1);
viii. the chapter 14 gift tax election to treat a qualified payment right as other than a qualified payment under Code Sec. 2701(c)(3)(C)(i); and
ix. the chapter 14 gift tax election to treat any distribution right as a qualified payment under Code Sec. 2701(c)(3)(C)(ii).

An example of a 12-month extension relevant to partnerships is the election to adjust basis on partnership transfers and distributions under Code Sec. 754. This provision allows a partnership to elect to adjust the basis of partnership property in the case of a distribution of property or in the case of a transfer of a partnership interest. This election applies to all distributions of property by the partnership and all transfers of interest during the tax year in which the election is filed and all subsequent years. The election is made by filing a written statement with the partnership return for the tax year during which the distribution or transfer occurs.[9] A missed Code Sec. 754 election can be corrected if the partnership takes corrective action by filing an amended return with the written statement attached within 12 months of the original deadline for the return, including a valid extension.

Next, there is an automatic six-month extension to make a regulatory or statutory election that is not included in the list of elections eligible for the automatic 12-month extension, whose due dates are the due date of the return or the due date of the return, including extension, provided the taxpayer timely filed its return for the year for which the election should have been made and the taxpayer took corrective action within that six-month period.[10] The automatic six-month extension does not apply to elections that must be made by the due date of the return, excluding extension.

Other Extensions Under Treas. Reg. §301. 9100-3

If a taxpayer who missed the deadline for filing a *regulatory* election does not meet the requirements for an automatic extension, it can request an extension under Reg. §301.9100-3. This form of relief is only available to a taxpayer who establishes "to the satisfaction of the Commissioner" that it "acted reasonably and in good faith, and the grant of relief will not prejudice the Government."[11] If the taxpayer meets these criteria, the IRS must grant relief.[12] Note that this form of relief is available only for regulatory elections, and not statutory elections, as the IRS's position is that it does not have authority to grant Section 9100 relief for statutory elections which do not meet the requirements for the six-month extension.[13]

Although the standard, "acted reasonably and in good faith," requires consideration of the facts and circumstances, the regulations describe situations in which a taxpayer will be deemed to have acted reasonably and in good faith, and situations in which the taxpayer's conduct will be deemed not to have acted reasonably and in good faith.

First, a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer:
i. requests relief before the failure to make the election is discovered by the IRS;
ii. failed to make the election because of intervening events beyond the taxpayer's control;
iii. failed to make the election because, after exercising reasonable diligence (taking into account the taxpayer's experience and the complexity of the return or issue), the taxpayer was unaware of the necessity for the election;
iv. reasonably relied on the written advice of the IRS; or
v. reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election.[14] 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 competent to render advice on the election or aware of all relevant facts.[15]

A taxpayer will be deemed to have acted reasonably and in good faith if it establishes just *one* of the criteria stated above.[16] However, these criteria are applied strictly. In *K.Z. Acar*,[17] where the taxpayer attempted to make an election post-audit and without any claim of intervening events, the court found that with no evidence of reasonable diligence in attempting to learn the tax law, reliance on a tax professional or reliance on the IRS,

"[i]gnorance of the tax laws, standing alone, is insufficient to warrant the grant of a retroactive extension of time" under Reg. §301.9100-3.

Second, a taxpayer will be deemed to have *not* acted reasonably or in good faith if the taxpayer:

i. seeks to alter a return position for which an accuracy-related penalty either has been or could have been imposed under Code Sec. 6662 at the time the taxpayer requests relief, 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.

An example of a taxpayer knowing that an election was available, but not making such election, can be found in LTR 8817082.[18] This letter ruling was issued before the Section 9100 regulations were issued, but the outcome would be the same way today. There, the partnership's accountant did not make the Code Sec. 754 election because the "numbers on the K-1 were 'small' and suggested only a 'nominal interest,'" since one of the partners did not inform the accountant about the sale of partnership property. The IRS denied the request for extension, in part, because the taxpayer's accountant was aware of the election, but decided it was not worth pursuing.

In addition, LTR 8817082 is an example of improper use of hindsight because the partnership property was sold before the election was considered. With respect to hindsight, the regulation states: "If specific facts have changed since the due date for making the election that make the election advantageous to a 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." Another example of hindsight in the Code Sec. 754 context is LTR 8220115.[19] In that letter ruling, A, a partner in a partnership, died, and A's estate did not request that the partnership make a Code Sec. 754 election. A's estate later learned about the benefit of making a Code Sec. 754 election and directed the partnership to apply for Section 9100 relief. The IRS denied the request, however, because the partnership's main asset was sold before the request for Section 9100 relief was submitted, which gave the partnership the opportunity to use hindsight in determining whether to make the election.

In *L.S Vines*,[20] the leading case on hindsight, the Tax Court considered whether the IRS should have granted Section 9100 relief to allow a late-filed mark-to-market election under Code Sec. 475(f). Code Sec. 475(f) applies to traders of securities and allows such qualified persons to make a mark-to-market election in their method of accounting for tax purposes, which allows them to account for losses as ordinary losses. The mark-to-market election is due no later than the due date for the return for the year immediately preceding the election year, *i.e.,* the taxpayer must attach a Form 3115 to a timely filed original federal income tax return for the year of the election. The Tax Court found that the taxpayer was entitled to relief because he filed the election request in the year in which it should have been filed—only months after the due date—with no trading in the interim, and with no tax liability that would be decreased as a result of the late filing. Because there was no trading between the due date of the election and the application for Section 9100 relief, the taxpayer did not use hindsight. In contrast, in another case decided after *Vines*, the court found that a request to file a late mark-to-market election was a "classic example of taxpayers who use the benefit of hindsight," where the taxpayers sought to retroactively convert capital losses into ordinary losses several years later, while continuing to trade in the interim.[21]

Recognizing the distinction between regulatory and statutory elections is the first step in understanding when and how late-filed elections will be permitted.

In addition to establishing that the taxpayer acted reasonably and in good faith, the IRS must find that the interests of the government will not be prejudiced by a grant of relief.[22] 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 tax years affected by the election than it would have had if the election had been timely made, taking into account the time value of money. Similarly, if the election would result in those affected taxpayers, in the aggregate, having a lower tax liability than if the election had been timely made, the government's interests are prejudiced.[23]

The interests of the government may also be prejudiced if the tax year at issue is otherwise closed for assessment under Code Sec. 6501(a).[24] 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

because granting relief will not result in the taxpayer or other affected taxpayer having a lower tax liability than if the election had been timely made.[25] In *J.M. Mezrah*,[26] the petitioner was denied Section 9100 relief to file a late election under Code Sec. 108(c)(3)(C) (election to exclude relief of indebtedness income). The IRS denied the request because it found that the government's interests would be prejudiced because the late election would result in a reduction in basis in the partner's proportionate interest in depreciable property held by the partnership, and the taxpayers had taken depreciation deductions beyond their partnership basis for closed tax years. Accordingly, had the late-filed election been granted, the taxpayers could have excluded the cancellation of indebtedness income from the year for which they were requesting relief, but the statute of limitations barred the IRS from reducing the depreciation deductions in earlier years. Recognizing that their position would whipsaw the IRS, the taxpayers offered to refund any benefit they received during the closed years from depreciation deductions taken beyond the reduced partnership basis. The IRS nonetheless denied the request for Section 9100 relief. The Tax Court noted that the taxpayer's position may have led to a settlement, but that because it did not have jurisdiction over closed tax years, it could not take into consideration the petitioner's proposal, and was constrained to find that allowing the late election would prejudice the interests of the government.

[I]f the election would result in those affected taxpayers, in the aggregate, having a lower tax liability than if the election had been timely made, the government's interests are prejudiced.

In addition, a higher standard applies to late requests to change accounting methods or tax years. The interests of the government are deemed to be prejudiced except in "unusual and compelling circumstances" if the taxpayer seeks an extension for an accounting method election (i) that is governed by Reg. §1.446-1(e)(3)(i) (requiring advance written consent of the Commissioner for change in method of accounting); (ii) that requires an adjustment under Code Sec. 481(a) (or would require such an adjustment if the taxpayer had changed to the method of accounting for which relief is requested in a tax year subsequent to the tax year the election should have been made); (iii) would permit a change from an impermissible method of accounting that is an issue under consideration by the IRS (through examination, appeals or a federal court), and the change would provide a more favorable method or more favorable terms and conditions than if the change were made as part of an examination; or (iv) that provides a more favorable method of accounting or more favorable terms and conditions if the election is made by a certain date or tax year.[27]

Likewise, the government's interests are deemed to be prejudiced "except in unusual and compelling circumstances" if an election is an accounting period election (other than an election to use other than the required tax year under Code Sec. 444), and the request for relief is filed more than 90 days after the due date for filing the Form 1128 (*Application to Adopt, Change, or Retain a Tax Year*) or other required statement.[28]

Whether there are unusual and compelling circumstances warranting a change in method of accounting or a change in tax years is decided on "a case-by-case basis in light of all applicable facts and circumstances."[29] For example, in LTR 9329036,[30] a partnership sought permission to change its accounting period after failing to timely file an application on Form 1128. The partnership had failed to timely file the Form 1128 because although it consulted with its bookkeeper, outside accountant and the accounting firm handling the partnership's audit prior to the due date, and had decided to change its tax year-end, it had limited staff and resources, and the outside accountant was spending most of his time assisting with the audit of the partnership. The IRS found that these circumstances were not unusual and compelling and denied relief.

In contrast, in *Vines*, the Tax Court found that if the "unusual and compelling circumstances" test did apply to mark-to-market elections, the petitioner had satisfied that standard. Petitioner suffered a $25 million loss when his trading accounts were liquidated three days before the deadline for timely filing a Code Sec. 475(f) election; petitioner's tax advisor, who had full knowledge of petitioner's trading activities and losses, was unaware of the election, and as soon as petitioner learned about the existence of the election, he immediately retained an attorney to submit his request for Section 9100 relief.

If all of the requirements for Section 9100 relief are met, the IRS may impose conditions on the grant of relief. The request for Section 9100 relief does not suspend the period of limitations on assessment under Code Sec. 6501(a). Thus, before granting relief, the IRS may require the taxpayer to consent to an extension of the period of assessment for the tax year in which the election should

have been made and any tax years that would have been affected by the election had it been timely made.[31]

Another common condition to the grant of Section 9100 relief is illustrated in LTR 201352004,[32] in which X, an entity formed under the laws of a foreign country, failed to timely file the Form 8832 *Entity Classification Election* to be classified as a partnership for federal income tax purposes. Thereafter, owner transferred 100 percent of its interests in X to Y, a state corporation that became the sole owner of X. The IRS ruled that X had satisfied the Section 9100 requirements, but made the grant of relief contingent on X and Y filing all required returns and amended returns for all open years consistent with the requested relief.

Procedures for Requesting Relief under Reg. §301.9100-3

A request for relief under Reg. §301.9100-3 is a request for a letter ruling, and must be submitted in accordance with the procedures for requests for letter rulings and must be accompanied by the applicable user fee, which is currently $6,900.[33] The request for relief can be submitted even after an examination of a return has begun or the issues are being considered by Appeals or a federal court.[34] A helpful guide to the letter ruling requirements can be found in Rev. Proc. 2014-1, Appendix C, entitled "Checklist: Is Your Letter Ruling Complete?" First, the taxpayer (or its representative) must submit a detailed affidavit describing the events that led to the failure to make a valid election and to the discovery of the failure. If the taxpayer is claiming that it relied on a qualified tax professional, the taxpayer's affidavit must describe the engagement and responsibilities of the professional and the extent to which the taxpayer relied on the professional.[35] The taxpayer must submit detailed affidavits from other individuals having knowledge or information about the events that led to the failure to make the election and the discovery of the failure. The taxpayer also must submit affidavits from the following people: the return preparer, any individual (including an employee of the taxpayer) who made a substantial contribution to the preparation of the return and any accountant or attorney, knowledgeable in tax matters, who advised the taxpayer with regard to the election. The affidavit must describe the engagement and responsibilities of each individual as well as the advice that the individual provided to the taxpayer."[36] An example in Reg. §301.9100-3 states that where a taxpayer hired a qualified tax professional who failed to advise him or her that a particular election was necessary, assuming all other criteria are satisfied, the IRS would grant the election if the professional submitted an affidavit stating that he or she failed to advise the taxpayer that the election was necessary.[37]

The request for Section 9100 relief also must contain the following information and documentation:[38]

i. whether the taxpayer's return for the tax year(s) at issue or that would have been affected by the election if it had been timely made is being examined by a district director or is being considered by an appeals office or a federal court;[39]
ii. when the applicable return, form or statement used to make the election was required to be filed and when it was actually filed;
iii. a copy of any document that refers to the election;
iv. upon request, a copy of the taxpayer's return for any tax year for which the taxpayer requests an extension of time to make the election and any return affected by the election; and
v. copies of returns of other taxpayers affected by the election, if any.

[I]f the IRS assesses a deficiency as a result of the denial of the extension to make the election, the taxpayer can challenge the denial of Code Sec. 9100 relief in the deficiency procedure.

Review of Denial of Relief Under Reg. §301.9100-3

There is no stand-alone judicial review of a denial of Reg. §301.9100-3 relief. However, if the IRS assesses a deficiency as a result of the denial of the extension to make the election, the taxpayer can challenge the denial of Section 9100 relief in the deficiency procedure. For example, in *Vines* and *Mezrah*, the Tax Court reviewed the IRS's decision to deny the taxpayers' application for Section 9100 relief.[40] In *Acar, Lehrer* and *Perkins,* the Tax Court falls short of announcing a rule that a taxpayer must make an administrative request for Section 9100 relief before seeking such relief in the Tax Court, but in each of these cases, the Tax Court held that requests for Section 9100 relief made for the first time, either in the petition or otherwise during the Tax Court proceedings, were made too late because they gave the taxpayers an

impermissible benefit of hindsight.[41] In the refund suit context, however, the Court of Federal Claims has held that a taxpayer cannot raise Section 9100 relief for the first time under the substantial variance doctrine, which requires a taxpayer to first present all arguments for relief administratively.[42]

ENDNOTES

1 Reg. §301.9100-1(b). Section 9100 relief is not available for extensions of time for filing tax returns under Code Sec. 6081. Automatic extensions for entity classification elections are handled under Rev. Proc. 2009-41, 2009-39 IRB 4.01, which permits late filing where (i) the entity failed to obtain its preferred classification solely because the proper form was not filed in a timely manner; (ii) the entity either has not yet filed a tax return or has filed returns consistent with its preferred classification; and (iii) the entity has reasonable cause for its failure to timely file the election. Otherwise the taxpayer must request a private letter ruling under Reg. §9100-3.

2 *Id.*

3 Reg. §301.9100-1(d).

4 Reg. §§301.9100-1(a); -2(c).

5 Reg. §301.9100-2(c).

6 *Id.*

7 *Id.*

8 Reg. §301.9100-2(a).

9 Reg. §1.754-1(b).

10 Reg. §301.9100-2(b).

11 Reg. §301.9100-3(a).

12 *L.S. Vines*, 126 TC 279, Dec. 56,512.

13 Some examples of elections with statutory deadlines that are not eligible for Section 9100 relief are Code Sec. 126(c)(2) (election for Code Sec. 126(a) [providing for specific exclusions of cost-sharing payments from gross income] and Code Sec. 1255 [exempting from income any gain from disposition of property under Code Sec. 126(a)] not to apply); Code Sec. 172(b)(1)(H)(iii)(II) (election to carry back net operating loss up to five preceding tax years for a 2008 or 2009 NOL for a stand-alone entity return); Code Sec. 174(b)(2) (election to amortize certain research and experimental expenditures); Code Sec. 1294(d) (election to extend the time for payment of undistributed passive foreign investment company earnings tax liability for the tax year); Code Sec. 6015(b)(1)(E) (innocent spouse). *See* October 14, 2013 letter of the American Institute of Certified Public Accountants to Congress re "Administrative Relief for Various Statutory Elections," reprinted in Tax Analysts, Doc. 2013-23912.

14 Reg. §301.9100-3(b)(1).

15 Reg. §301.9100-3(b)(2).

16 *Supra* note 12.

17 *K.Z. Acar*, DC-CA, 2006-2 USTC ¶50,529; *aff'd*, CA-9, 2008-2 USTC ¶50,564, 545 F3d 727.

18 LTR 8817082 (Feb. 4, 1988).

19 LTR 8220115 (Feb. 22, 1982).

20 *Supra* note 12.

21 *Supra* note 12.(contrasting *R.A. Lehrer,* 90 TCM 20, Dec. 56,088(M), TC Memo. 2005-167); *see also M.N. Kantor*, 96 TCM 500, Dec. 57,633(M), TC Memo 2008-297 (petitioner, a Wall Street trader with a master of laws degree, used hindsight in claiming election does not qualify for Section 9100 relief); *S. Kohli*, 98 TCM 572, Dec. 58,021(M), TC Memo 2009-287 (2009) (Section 9100 relief not warranted where taxpayer attempted to make mark-to-market election late to convert capital losses into ordinary losses while continuing to trade).

22 Reg. §301.9100-3(c).

23 Reg. §301.9100-3(c)(1)(i).

24 Reg. §301.9100-1(c)(1)(ii).

25 *Id.*

26 *J.M. Mezrah*, 95 TCM 1444, Dec. 57,430(M), TC Memo 2008-123.

27 Reg. §301.9100-3(c)(2).

28 Reg. §301.9100-3(c)(3).

29 TD 8742, 1998-1 CB at 390.

30 LTR 9329036 (Apr. 29, 1993).

31 Reg. §301.9100-3(d)(2).

32 LTR 201352004 (Aug. 15, 2013).

33 Reg. §301.9100-3(e)(5); Rev. Proc. 2014-1. The fee was reduced from $10,000 for requests received by the IRS after February 4, 2014. Rev. Proc. 2014-1, Appendix A. The request is submitted to the appropriate Associate Chief Counsel's Office (Corporate, Financial Institutions and Products, Income Tax and Accounting, International, Passthroughs and Special Industries, Procedure and Administration, or Tax Exempt and Government Entities). Rev. Proc. 2014-1.

34 Rev. Proc. 2014-1, at §5.03.

35 Reg. §301.9100-3(e)(2). The affidavit also must be accompanied by a dated declaration, signed by the taxpayer, which states: "Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and, to the best of my knowledge and belief, the request contains all the relevant facts relating to the request, and such facts are true, correct, and complete." An individual who signs for an entity must have personal knowledge of the facts and circumstances at issue. *Id.*

36 Reg. §301.9100-3(e)(3). The third-party affidavits must include the name, current address, and taxpayer identification number of the individual, and be accompanied by a dated and signed declaration stating: "Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and, to the best of my knowledge and belief, the request contains all the relevant facts relating to the request, and such facts are true, correct, and complete." *Id.*

37 Reg. §301.9100-3(f) (Example 2).

38 Reg. §301.9100-3(e)(4).

39 The taxpayer must notify the Associate Chief Counsel's office considering the request for relief if the IRS starts an examination of any such return while the taxpayer's request for relief is pending. Reg. §301.9100-3(e)(4)(i).

40 *Vines, supra* note 12; *Mezrah, supra* note 26.

41 *Acar, supra* note 17; *R.L. Perkins*, 129 TC 58, Dec. 57,099 (2007); *R.A. Lehrer,* 90 TCM 20, Dec. 56,088(M), TC Memo. 2005-167.

42 *E. Marandola, Jr.*, FedCl, 2007-1 USTC ¶50,445, 76 FedCl 237. The Court of Claims suggests, but does not hold, that the taxpayer must file a request for a private letter ruling under Section 9100, and instead states that there is a substantial variance if the taxpayer did not apply for Section 9100 relief or raise the issue in an amended return.