Internal Revenue Service

Department of the Treasury

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Taxpayer =

State A =

State B =

$A =

$B =

$C =

Member 1 =

Member 2 =

Year 1 =

Year 2 =

Year 3 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Property 1 =

Property 2 =

Property 3 =

Accounting Firm =

Accountant 1 =

Accountant 2 =

Accountant 3 =

Accountant 4 =

Dear

This letter responds to Taxpayer's request for permission to revoke its election out of the installment method of reporting the gain from three real property sales. This letter ruling is based on the following representations, subject to verification upon audit.

FACTS

Taxpayer, a calendar year LLC taxed as a partnership, as lessor owns commercial and residential real estate which it leases to others. Taxpayer has two partners, Member 1 and Member 2 (the members) who are husband and wife. The members filed a joint federal income tax return for Year 1 and Year 2 and will also file a joint federal income tax return for Year 3.

At the end of Year 1 Taxpayer sold Property 1. Pursuant to the sale Taxpayer received a note, secured by a deed to secure debt on Property 1, payable in level monthly installments over a ten-year period. Taxpayer retained Accounting Firm, located in State A, to prepare its Year 1 federal income tax return. In conjunction therewith Taxpayer provided Accounting Firm with a copy of the documents, including the note, pertaining to the sale of Property 1. In preparing the return Accountant 1 discovered that depreciation recapture on the sale of section 1250 property does not qualify for installment sale reporting. From this she erroneously concluded that no portion of the gain from the sale of section 1250 property may be reported using the installment method. She prepared Taxpayer's Year 1 federal income tax return reporting the entire gain from the sale of Property 1.

On Date 1 of Year 2 Taxpayer sold Property 2. Pursuant to the sale Taxpayer received a note, secured by a deed to secure debt on Property 2, payable in level monthly installments of $A with a final balloon payment of any remaining principal and

interest due on Date 2. On Date 3 of Year 2 Taxpayer sold Property 3. Pursuant to the sale Taxpayer received an approximately 10% down payment of $B and a note payable in level monthly installments of $C with a final balloon payment of any remaining principal and interest due on Date 4.

Prior to Taxpayer's sale of Property 3, Member 1 met with Accountant 2 to discuss the tax implications of the proposed sale. Member 1 wanted to know if Taxpayer would be required to report the entire amount of the gain for the taxable year of the sale if Taxpayer received approximately a 10% down payment and took a note for the balance of the purchase price. Accountant 2 indicated that the gain could be reported on the installment method as payments were received. At the meeting Taxpayer, through Member 1, explicitly indicated its desire to report gain from the sale of Property 2 and Property 3 using the installment method.

During the meeting Accountant 2 was made explicitly aware that Taxpayer generally desired to use installment method reporting where possible when notes were received in conjunction with the sale of property. However, following the meeting no one at Accounting Firm attempted to confirm that the sale of Property 1 had been reported using the installment method.

Taxpayer retained Accounting Firm to prepare its Year 2 federal income tax return. In conjunction therewith Taxpayer provided Accounting Firm with a copy of the documents, including the notes, pertaining to the sales of Property 2 and Property 3. Because she had prepared Taxpayer's Year 1 return, Accountant 1 was also assigned the primary responsibility to prepare Taxpayer's Year 2 federal income tax return. As she had done on the Year 1 return, Accountant 1 reported the entire amount of the gains from the sales of Property 2 and Property 3 for the taxable year of the sales. Accountant 3 reviewed the return but did not change the treatment of the property sales. Accountant 2, who signed the return, also did not change Accountant 1's treatment of the property sales.

Member 1 and Member 2 retained Accounting Firm to prepare their Year 2 joint federal income tax return. Accountant 4 signed this return. Accounting Firm finished preparing the members' joint federal income tax return shortly before the April 15, Year 3 due date. Accounting Firm had to ship these returns to Member 1 and Member 2 who were in State B when the returns were completed. Because of this Accountant 2 did not review the members' joint federal income tax return and did not see how the property sales were treated on that return.

Shortly after the filing of the returns Member 1 consulted with an accountant not associated with Accounting Firm. In conjunction with reviewing Taxpayer's and the members' federal income tax returns for Year 1 and Year 2, Member 1 became aware that Accounting Firm failed to report the sales of Properties 1, 2, and 3 using the installment method. Member 1 then contacted Accountant 2 who indicated that the

installment method should have been used to report the gains from the sales. Subsequently, Accounting Firm prepared the request for permission to revoke the elections out of the installment method for the three sales at issue. Member 1 signed the ruling request on August 3, Year 3, and the Service received the request on August 6, Year 3.

On or before August 3, Year 3 there were no defaults on the installment notes arising from the sales that are the subject of this ruling request nor were the members aware of any information indicating imminent defaults on any of the notes. On or before August 3, Year 3 the members did not become aware of their lack of entitlement to any deduction, loss, exclusion from gross income, or credit claimed on their Year 1 or Year 2 federal income tax returns which was taken into account in reducing the amount of federal income tax originally reported on the sales that are the subject of this ruling request. Finally, the members represent that Taxpayer's request for permission to revoke the elections out of the installment method for the sales at issue is not motivated by a mere change in mind or by consideration of the relative advantages of changing the method of reporting gain based on information not available or taken into account when the sales were initially reported (other than the discovery that Accounting Firm failed to use the installment method in reporting such sales).

LAW AND ANALYSIS

Section 453(a)[1] generally requires income from an installment sale to be taken into account under the installment method. Section 453(b)(1) defines an installment sale as a disposition of property where at least one payment is to be received after the close of the taxable year in which the disposition occurs. However, section 453(b)(2), in conjunction with section 453(l), excludes certain sales from installment sales treatment, including dealer dispositions of real property. With certain exceptions, section 453(l)(1)(B) defines a dealer disposition of real property as any disposition of real property held by a taxpayer for sale to customers in the ordinary course of the taxpayer's trade or business.

Section 453(d)(1) allows a taxpayer to elect out of using the installment method. Under section 1.453-1(d)(3) of the Income Tax Regulations a taxpayer who reports an amount realized equal to the selling price including the full face amount of any installment obligation on a timely tax return filed for the taxable year in which the installment sale occurs is considered to have elected out of using the installment method.

Section 453(d)(3) provides that a taxpayer must obtain the consent of the

[1] All section references are to sections of the Internal Revenue Code of 1986 as in effect for the taxable years at issue.

Service to revoke an election out of using the installment method. Section 1.453-1(d)(4) provides that revocation of an election out will not be permitted when one of its purposes is the avoidance of federal income taxes or when the taxable year in which any payment was received has closed.

Except as otherwise provided in regulations, section 453(d)(2) requires a taxpayer who desires to elect out of the installment method for a qualifying sale to do so on or before the due date (including extensions) for the taxpayer's federal income tax return for the taxable year of the sale. Section 1.453-1(d)(3)(ii) provides that late elections out of the installment method will be permitted only in those rare circumstances when the Service concludes that the taxpayer had good cause for failing to make a timely election out.

In Rev. Rul. 90-46, 1990-1 C.B. 107 the Service discussed some criteria used in determining whether to grant taxpayers permission to make late elections out of the installment method. Although Rev. Rul. 90-46 only deals with late elections out, the Service has used similar criteria in determining whether to allow taxpayers to revoke elections out of installment reporting.

If a taxpayer intends to use the installment method when reporting a sale but later has a change of mind because of a simple change in preference or a subsequent change in law or circumstances, Rev. Rul. 90-46 makes clear permission to change reporting methods will not be granted. It follows that any change in initial intent because of hindsight does not justify granting permission to change. Hindsight's scope extends beyond reevaluations of prior decisions because of subsequently occurring events. It may also include reevaluations of prior decisions because of the subsequent discovery of facts existing at the time of the initial reporting decision or mere reevaluations of facts which were known at the time of the initial reporting.

On the other hand, a taxpayer may initially intend to elect out of installment reporting but that intent may be thwarted by the mistake of a third party. If the taxpayer makes a timely effort to correct the mistake, Rev. Rul. 90-46 provides that the Service may consider this one of the rare circumstances in which it will grant permission to make a late election out of the installment method.

In the instant case Taxpayer supplied Accounting Firm with documents containing information sufficient to indicate the possible application of installment sale reporting for gains from the sales at issue. Accounting Firm did not use the installment method to report the gains because of a legal error. The legal error consisted of Accountant 1's erroneous conclusion that no portion of the gain from the sale of section 1250 property qualifies to be reported using the installment method and the failure of other accountants to correct that error in reviewing the relevant tax returns.

With regard to the sale of Property 2 and Property 3 Member 1 specifically

requested that Accounting Firm use the installment method to report such sales. There is no indication that either Member 1 or Member 2 specifically requested that the installment method be used to report the sale of Property 1. However, the members relied on Accounting Firm to prepare Taxpayer's tax return in a manner which would minimize their federal income tax liability. Based on the circumstances as they existed at the due date of the Year 1 returns, there appears to have been no reasonable basis not to have used the installment method if available.

When Member 1 learned of Accounting Firm's failure to use the installment method to report gains from the sales at issue, Member 1 immediately contacted Accounting Firm in an attempt to rectify the situation. With regard to the sales of Property 2 and Property 3 Member 1 contacted Accounting Firm just over two months after the due date of Taxpayer's and the members' Year 2 return. Less than two months after this initial contact Accounting Firm prepared and Taxpayer filed a request for permission to revoke the elections out of the installment method. With regard to the sale of Property 1 Member 1's discovery of Accounting Firm's failure to use the installment method and contact of Accounting Firm occurred just over fourteen months after the due date of Taxpayer's and the members' Year 1 return.

In the periods following the initial reporting of the sales no events have occurred that indicate that electing out of the installment method for the sales yields a better result for members than using installment reporting. Rather, events to date indicate installment method reporting to be the preferable course of action. However, based on all of the facts and circumstances as represented by Taxpayer, its request to revoke its election out of the installment method does not appear to be based on hindsight. Rather, based on the representations made, it appears that Taxpayer initially intended to use installment method reporting for the sales at issue and that this intent, through no fault of Taxpayer, was frustrated by Accounting Firm. Moreover, we believe Member 1 discovered the failure to use installment method reporting and initiated corrective action in a reasonable amount of time with regard to each of the sales at issue.

To the extent one or more of the sales at issue qualify as an installment sale within the meaning of section 453(b), subject to the time constraints set forth in the following paragraph we grant Taxpayer permission to revoke its election out of using the installment method for that particular sale. However, we express no opinion on the question of whether Taxpayer initially qualified to use the installment method to report the gains from the sales of Property 1, Property 2, or Property 3. Thus, we express no opinion on whether any of the sales of property at issue constitute dealer dispositions within the meaning of section 453(l)(1)(B), which section 453(b)(2)(A) excludes from the definition of installment sales.

Permission to revoke the election out of installment method reporting for any of the sales at issue is granted for the period that ends 75 days after the date of this letter. To revoke the election out of the installment method for any of the sales at issue

Taxpayer must file an amended federal income tax return for the taxable year of the sale and any previously filed return on which a portion of the gain from the sale is reportable under the installment method. A copy of this letter must be attached to the amended returns.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent. If you have any questions concerning this ruling please call the contact person listed above.

Sincerely yours,

Associate Chief Counsel
(Income Tax & Accounting)

By_____
George Baker
Chief, Branch 7

cc: