Internal Revenue Service

Number: **201239004**
Release Date: 9/28/2012

Index Number: 475.08-00, 9100.00-00, 9100.10-01

Department of the Treasury
Washington, DC 20224

[Third Party Communication:
Date of Communication: Month DD, YYYY]

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:FIP:B03
PLR-126136-10

Date:
June 27, 2012

Attn:

TY:

Legend

Taxpayer =

Parent Company =

Company A =

Investment Advisor =

X securities =

Y securities =

Year 1 =

Year 2 =

Year 5 =

Date 1 =

Date 2 =

Date 3 =

Month 1 =

Amount 1 =

Amount 2 =

Amount 3 =

Amount 4 =

Amount 5 =

Amount 6 =

Dear :

This responds to a letter dated Date 3, that was submitted on behalf of Taxpayer by Parent Company, requesting a ruling that it had made a valid section 475(f)(1) election in Year 1 by reason of substantial compliance with the section 475 (f) election requirements. In the alternative, if it is found that a valid election had not been made, taxpayer requests an extension of time under § 301.9100-3 of the Procedure and Administration Regulations to make an election under § 475(f)(1) of the Internal Revenue Code to treat Taxpayer as a trader in securities and subject to mark-to-market accounting under section 475.

FACTS

Taxpayer was at all times at issue a wholly owned subsidiary of Parent Company and was included in its consolidated tax return.[1] Taxpayer represents that it was formed on Date 1 by a contribution of asset backed securities ("ABS") from Parent Company in a section 351 transaction.[2] Taxpayer asserts that during Month 1, it bought and sold "substantial volumes" of X securities and entered into numerous of Y securities.

---

[1] During the years at issue, Parent Company was known as Company A. Subsequent to the years at issue, Company A's name was changed to Parent Company.

[2] This statement regarding the contribution of securities is contested by the audit team. In the examination of the Taxpayer for the relevant years at issue, the agent asserts that cash was transferred, not securities. Taxpayer submitted documents it claims supports its position that securities were transferred, but based upon our review of these documents, we do not see support for the transfer of actual securities. If securities were transferred, then Taxpayer (non-dealer) would be required to continue to mark only the transferred securities, not any securities it acquired outside of the transfer by Parent. See Treas. Reg. § § 1.1502-13(c)(7) Example 11.

Taxpayer asserts that it had bought and sold Amount 1 of X securities, and that it did so in Amount 2 issuances.[3]

Taxpayer represents that Parent Company was a dealer in securities and used a mark-to-market method of accounting under section 475. Taxpayer represents that it also used a mark-to-market method of accounting even though it did not make an election under section 475(f). Taxpayer asserts that it did not make that election because it thought that it qualified as a dealer in securities, and even if it was not a dealer in securities, it was bound to use the same method of accounting as Parent Company under the consolidated return regulations.[4]

During the Year 2 audit of Parent Company, the Service proposed to disallow the losses arising from Taxpayer's use of mark-to-market accounting. The agent had determined that Taxpayer did not qualify as a dealer in securities and should not have been marking under section 475. Parent Company raised the issue of whether Taxpayer qualified as a trader and whether it could be granted 9100 relief during the course of its audit examination for Year 2. At that time, the agent did not object to Taxpayer raising the issue as to whether it qualified as a trader and whether it is entitled to 9100 relief. After discussions with the examining agent, Taxpayer filed this ruling request. As the audit continued, the agent subsequently raised an issue as to whether Taxpayer qualified as a trader. The examining agent contends that Taxpayer acted more like an investor. It is the examining team's position that Taxpayer was an investor and through its managed account its Investment Advisor bought and sold the above-mentioned securities.

Taxpayer was liquidated on Date 2, and no longer exists. This ruling request relates to Year 1.

Furthermore, Taxpayer makes the following additional representations:

1. Granting the relief will not result in Taxpayer having a lower tax liability in the aggregate for all years to which the regulatory election applies than it would have had if the election had been timely made (taking into account the time value of money).

2. Taxpayer does not seek to alter a return position for which an accuracy-related penalty has been or could be imposed under § 6662 of the Code at the time the Company requested relief.

---

[3] The audit team asserts that Taxpayer had a managed account with Investment Advisor. Investment Advisor bought and sold the securities referenced above.

[4] Taxpayer asserts that under Treas. Reg. §1.1502-17(c), it was required to use the section 475 method of accounting. However, neither the audit team nor the various Chief Counsel offices that have looked at this issue, including LB&I and the National Office, agree.

LAW AND ANALYSIS

Section 475(f) Election

Section 475(f) provides that a taxpayer engaged in a trade or business as a trader in securities may elect to apply the mark-to-market method of accounting to securities held in connection with such trade or business. *See* section 475(f)(1). Section 7805(d) provides that, except to the extent otherwise provided by the Code, any election shall be made at such time and in such manner as the Secretary shall prescribe.

On February 16, 1999, the Internal Revenue Service published Revenue Procedure 99-17, 1999-1 C.B. 503, (section 6 superseded by Rev. Proc. 99-49, 1999-2 C.B. 725, which was clarified, modified, amplified, and superseded by Rev. Proc. 2002-9, 2002-1 C.B. 327). Rev. Proc. 99-17 provides the exclusive procedure for traders in securities to make an election to use the mark-to-market method of accounting under section 475(f). This revenue procedure applies both to existing taxpayers who are changing to the mark-to-market method of accounting for securities and to new taxpayers who are adopting that method.

Section 5.03(2) of Rev. Proc. 99-17 provides, in relevant part, that a new taxpayer (for which no federal income tax return was required to be filed for the taxable year immediately preceding the election year) may make an election under section 475(f) for a tax year beginning on or after January 1, 1999, by placing in its books and records no later than two months and 15 days from the first day of the election year a statement that describes the election being made, the first taxable year for which the election is effective, and the trade or business for which the election is made. To notify the Service that the election was made, the new taxpayer must attach a copy of the statement to its original federal income tax return for the election year.

Substantial Compliance

Taxpayer seeks a ruling that it has made a valid section 475(f) election because it has substantially complied with the election requirements. It is Taxpayer's position that under the substantial compliance doctrine, it may be deemed to have made an election under section 475(f) even though it never technically did so, if the requirements for the election that have not been satisfied do not relate to the substance of the applicable election. Taxpayer argues that because it always marked its securities under section 475 since its incorporation, it has substantially complied with the election requirements of section 475(f)(1).

The substantial compliance doctrine is a narrow equitable doctrine that courts use to avoid hardship in cases where the taxpayer establishes that he or she intended to comply with a provision, did everything reasonably possible to comply with the provision, but did not comply with the provision because of a failure to meet the provision's specific requirements. The doctrine can only be applied where invocation of it would not defeat the policies of the underlying statutory provisions. Sawyer v.County of Sonoma, 719 F.2d 1001, 1008 (9th Cir. 1983). In some cases the courts have held that under the doctrine of substantial compliance, where taxpayers have not complied with all the requirements of an election provision of the statute or regulations, an election may nevertheless be deemed to have been made by the taxpayer if the requirements that have not been satisfied do not relate to the substance or essence of the applicable election. See Wilkerson v. Commissioner, T.C. Memo 1993-463. In those cases, the courts held that substantial compliance with regulatory requirements may suffice when such requirements are procedural and when the essential statutory purposes have been fulfilled. Taylor v. Commissioner, 67 T.C. 1071 (1977); Hewlett-Packard Co. v. Commissioner, 67 T.C. 736 (1977).

The Courts have repeatedly held that a taxpayer who has failed to follow the election requirements under Rev. Proc. 99-17 has not made a valid election under section 475(f). See Kantor v. Commissioner, T.C. Memo 2008-297; Knish v. Commissioner, T.C. Memo 2006-268; Acar v. United States, 2006 U.S. Dist. LEXIS 60859, 98 A.F.T.R.2d(RIA) 6296, 2006-2 USTC par. 50,529 (N.D. Cal. 2006), aff'd 545 F.3d 727 (9th Cir. 2008); Marandola v. United States, 76 Fed. Cl. 237 (2007); Lehrer v. Commissioner, T.C. Memo 2005-167, aff'd non published opinion, 278 Fed. Appx. 549 (9th Cir. 2008). In Kohli v. Commissioner, T.C. Memo 2009-287, the Tax Court considered the issue of whether substantial compliance can apply in the case of a missed timely election under section 475(f). The Court found that the substantial compliance doctrine has no place in determining whether a timely election has been made. The Court made clear that Rev. Proc. 99-17 fixes a deadline by which the election must be made and taxpayer's failure to timely make the election prevents the application of the substantial compliance doctrine.

Because the Tax Court has specifically addressed the applicability of the substantial compliance doctrine to a late section 475(f) election and determined that it cannot apply, we do not need to address each of Taxpayer's arguments as to how it meets the five factors discussed in other non section 475(f) cases for purposes of determining whether it has substantially complied with the election requirements.

Section 9100 Relief

Section 301.9100-1(c) of the Income Tax Regulations provides that the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make a regulatory election, or a statutory election (but no more than 6 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. A regulatory election is defined in § 301.9100-1(b) as an election whose due date is prescribed by regulations or by a revenue ruling, a revenue procedure, a notice, or an announcement published in the Internal Revenue Bulletin),

Section 301.9100-3(a) through (c)(1)(ii) sets forth rules that the Internal Revenue Service generally will use to determine whether, under the particular facts and circumstances of each situation, the Commissioner will grant an extension of time for regulatory elections that do not meet the requirements of § 301.9100-2 for automatic extensions. The general rule for relief to be granted under this section is based upon taxpayer establishing that it acted reasonably and in good faith, and that the grant of relief will not prejudice the interests of the Government. Section 301.9100-3(b)(1) and (2) provide the qualifying circumstances for being deemed to have acted reasonably and in good faith. The exceptions to these qualifying circumstances are listed in paragraphs (b)(3)(i) through (iii) of § 301.9100-3. Generally when a taxpayer applies for relief under this section before the failure to make the regulatory election is discovered by the Service,[5] the taxpayer will be deemed to have acted reasonably and in good faith. Also when the taxpayer 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, it can fall within the deemed to have acted reasonably and with good faith test. Section 301.9100-3(c) provides 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 years to which the regulatory election applies than the taxpayer would have had if the election had been timely made (taking into account the time value of money) or if the taxable year in which a timely regulatory election should have been made is closed.

Section 301.9100-3(b)(3) describes three situations where a taxpayer is deemed to have not acted reasonably and in good faith. First, under § 301.9100-3(b)(3)(i), a taxpayer seeking to alter a return position for which an accuracy-related penalty has been or could be imposed under section 6662 is not acting reasonably and in good faith. Second, under § 301.9100-3(b)(3)(ii), a taxpayer who was informed in all material respects of the required election and the tax related consequences but chose not to timely file the election is not acting reasonably and in good faith in requesting permission to make a late election. Third, §301.9100-3(b)(3)(iii) provides that a taxpayer is deemed to have not acted reasonably and in good faith if the taxpayer uses hindsight in requesting relief. If specific facts have changed since the due date for making the election that make the election advantageous to the taxpayer, the Service will not ordinarily grant relief. In such a case, the Service will grant relief only when the taxpayer provides strong proof that the taxpayer's decision to seek relief did not involve hindsight.

[5] Taxpayer did not raise this issue before the failure to make the election was discovered by the Service, but the examining agent did not object to Taxpayer raising the request. However the agent subsequently determined that Taxpayer does not even qualify as a trader.

Section 301.9100-3(c)(2) provides special rules for accounting method regulatory elections. This section provides, in relevant parts, that the interests of the Government are deemed to be prejudiced by granting an extension of time, except in unusual and compelling circumstances, in several situations: first, if the accounting method regulatory election is subject to the procedure described in § 1.446-1(e)(3)(i) (requiring the advance written consent of the Commissioner) (see § 301.9100-3(c)(2)(i)); second, if the accounting method regulatory election for which relief is requested requires an adjustment under section 481(a) (or would require an adjustment under section 481(a) if the taxpayer changed to the method of accounting for which relief is requested in a taxable year subsequent to the taxable year the election should have been made) (see § 301.9100-3(c)(2)(ii)); third, if the accounting method regulatory election involves certain changes from an impermissible method of accounting (see § 301.9100-3(c)(2)(iii)); or fourth, if the accounting method regulatory election would provide a more favorable method of accounting or more favorable terms and conditions if the election is made by a certain date or taxable year (see §301.9100-3(c)(2)(iv)).

Section 4 of Rev. Proc. 99-17 states that the election under section 475(f) determines the method of accounting an electing trader is required to use for federal income tax purposes for securities subject to the election. If an electing trader's method of accounting for its taxable year immediately preceding the election year is inconsistent with section 475, the taxpayer is required to change its method of accounting to comply with its election. A taxpayer that makes a section 475(f) election but fails to change its method of accounting to comply with that election is using an impermissible method. Because the election is integrally related to the change in accounting method to mark-to-market, it is an accounting method regulatory election subject to § 301.9100-3(c)(2).

Rev. Proc. 2011-14 provides procedures by which a taxpayer may obtain automatic consent to change to the mark-to-market accounting method. However, the automatic change applies to a taxpayer only if the taxpayer has made a valid election under section 475(f) by complying with the requirements of Rev. Proc. 99-17 and is required to change its method of accounting to comply with the election. Section 23.01(2)(a) of the Appendix to Rev. Proc. 2011-14.

Taxpayer requests an extension of time to make an accounting method regulatory election that is subject to the provisions of § 301.9100-3. Relief under this section of the regulations will only be granted when taxpayer provides evidence satisfactory to the Commissioner that the taxpayer acted reasonably and in good faith and the granting of the relief will not prejudice the interests of the government. If specific facts have changed since the due date for making the election that make the election advantageous to a taxpayer, §301.9100-3(b)(3) provides that the Service will only grant relief when the taxpayer provides strong proof that its decision to seek relief did not involve hindsight. Without such proof a taxpayer is deemed to have not acted reasonably or in good faith.

Taxpayer was a new taxpayer in Year 1, and if it properly adopted a method of accounting under section 475(f), it should have done so by placing a statement that it was making the election in its books and records not later than 2 months and 15 days after the beginning of its first taxable year. In Year 5, Taxpayer is now asking for a late election for adoption of an accounting method. Based upon all the facts and representations submitted, we conclude that Taxpayer has not satisfied the requirements for our granting a reasonable extension of time to make an election under section 475(f) to be a trader in securities and to use the mark-to-market method of accounting.

First, Taxpayer's failure to make the regulatory election was discovered by the Service before Taxpayer filed for relief. See § 301.9100-3(b)(1)(i).

Second, taxpayer has failed to demonstrate that it acted reasonably and in good faith under § 301.9100-3(b)(3). Taxpayer did not file its request for relief until Date 3, years after it knew that its securities transactions had resulted in losses, losses it would like to carry back to offset income from profitable years. Although Taxpayer was marking under section 475(a), its improper marking as a dealer does not prevent hindsight from being used to decide to make the trader election under section 475(f). Therefore, Taxpayer has failed to demonstrate its decision to seek relief did not involve hindsight.

In addition, the interests of the government would be prejudiced by the granting of relief in this case under the special rules for accounting method regulatory elections under §§ 301.9100-3(c)(2)(ii) and (iii).

Finally, in the interests of sound tax administration, relief should not be granted when it becomes apparent that the Taxpayer may not even qualify to make the election. In this case, the Commissioner at the conclusion of its examination determined that Taxpayer was not a trader but rather was an investor.

CONCLUSION

Based on the information submitted and representations made, we conclude that Taxpayer has not substantially complied with the section 475(f) election requirements nor has it satisfied the requirements under the section 9100 regulations for granting a reasonable extension of time to elect under § 475(f) of the Code to be treated as a trader in securities under section 475.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Robert B. Williams
Senior Counsel, Branch 3
(Financial Institutions & Products)