

INTERNAL REVENUE SERVICE

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CC:ITA:B01/PLR-100185-02
PLR-100186-02

June 20, 2002

Re:

Legend

Fund 1 =
Fund 2 =
Parent 1 =

Parent 2 =

State X =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
Date 7 =
Date 8 =
Date 9 =
\$ a =
\$ b =
\$ c =
Advisor =
Auditors =
Administrator 1 =
Administrator 2 =
Accounting Agent =

Dear Sir or Madam:

This letter is in response to a request for rulings of December 19, 2001, submitted on behalf of Fund 1 and Fund 2, requesting relief under § 301.9100-3 of the Procedure and Administration Regulations to make the consent dividend election under § 565(a) of the Internal Revenue Code for Fund 1 and to increase the consent dividend election for Fund 2.

FACTS

Fund 1 and Fund 2 were incorporated on Date 1 in State X. Both Funds report their income for federal income tax purposes under an overall accrual method of accounting on a fiscal year ending Date 2. Each Fund is registered as a closed-end management investment company under the Investment Company Act of 1940, as amended, 15 U.S.C. § 80a-1, *et seq.* (1940 Act). Each Fund elected to be treated as a Regulated Investment Company (RIC) under § 851 beginning with their initial tax year ended Date 3. Fund 1 and Fund 2 represent that they have at all times since their incorporation intended to be treated as RICs.

Fund 1 is a 100 percent owned subsidiary of Parent 1, which also is registered as a closed-end management investment company under the 1940 Act. Parent 1 elected to be treated as a RIC under § 851 for its initial year ended Date 4. Parent 1 has at all times since its incorporation intended to be treated as a RIC.

Fund 2 is a 100 percent owned subsidiary of Parent 2, which also is registered as a closed-end management investment company under the 1940 Act. Parent 2 elected to be treated as a RIC under § 851 for its initial year ended Date 5. Parent 2 has at all times since its incorporation intended to be treated as a RIC.

The Funds have an investment advisor (Advisor), auditors (Auditors), administrators (Administrator 1 and Administrator 2¹), and an accounting agent (Accounting Agent). Accounting Agent maintains the books and records for the Funds. Administrator 1 prepares Fund 1's federal and state income tax returns. Auditors prepare the federal and state income tax returns for Fund 2. Advisor is responsible for, among other things, reviewing the Funds' tax returns and arranging for their execution and timely filing.

For their tax year ended Date 6, the Funds' federal income tax returns were timely filed. The Fund 2 return contained Form 972, Consent of Shareholder to Include Specific Amount in Gross Income, whereby Parent 2 agreed to include \$a in its taxable income, as well as the related Form 973, Corporation Claim for Deduction for Consent

¹ Administrator 2 was Fund 2's administrator only for its tax year ended Date 6.

Dividends.

During a review of certain financial data that commenced on or about Date 7, an employee of Advisor questioned the accretion of interest income on certain securities, predominantly zero coupon investments, owned by the Funds. After a series of discussions with Accounting Agent, it was determined that the Funds' interest income was understated for their tax year ended Date 6. On Date 8, the understatements were quantified to be \$b with respect to Fund 1 and \$c with respect to Fund 2. Also on Date 8, Advisor called Auditors to discuss the matter. Auditors recommended that Parents include in their taxable income the amount of the Funds' understated income for Parents' tax year ended Date 9 and to submit the instant request for relief. Parents filed their federal income tax returns for their tax year ended Date 9, timely, and included \$b and \$c in their respective taxable income.

Fund 1 and Fund 2 represent that at the time this request was filed, the Funds had not been contacted by the Internal Revenue Service with respect to an examination of their returns. To the best of the knowledge of the Funds and their Auditors, this request for relief was filed before the failure to make the elections was discovered by the Service.

Fund 1 and Fund 2 represent further that neither Fund used hindsight in making this request for relief. No facts have changed since the due date of the elections that make the elections advantageous to the Funds. Additionally, neither Fund seeks to alter a return position for which an accuracy-related penalty has been or could have been imposed under § 6662, or was fully informed of the required election and related tax consequences and chose not to file the election.

Also, the Funds submit that if an extension of time is granted to make the election under § 565 for Fund 1 and to increase the election by Fund 2, the interests of the government will not be prejudiced since there have been no events that occurred between the time the elections should have been made and the present, which would have the effect of lowering the Funds' tax liability in the aggregate. That is, if the consent elections had been timely made and in the correct amounts, the tax liability of each Fund, in the aggregate, would be the same as if relief were granted under this request.

LAW AND ANALYSIS

Section 565(a) provides that if any person owns consent stock (as defined in § 565(f)(1)) in a corporation on the last day of the taxable year of such corporation, and such person agrees, in a consent filed with the return of such corporation in accordance with the regulations, to treat as a dividend the amount specified in such consent, the amount so specified shall, except as provided in § 565(b), constitute a consent dividend for purposes of § 561 (relating to the deduction for dividends paid).

Section 1.565-1(a) of the Income Tax Regulations provides that the dividends paid deduction, as defined in § 561, includes the consent dividends for the taxable year. A consent dividend is a hypothetical distribution (as distinguished from an actual distribution) made by certain corporations to any person who owns consent stock on the last day of the taxable year of such corporation and who agrees to treat the hypothetical distribution as an actual dividend, subject to specified limitations, by filing a consent at the time and in the manner specified in § 1.565-1(b). Section 1.565-1(b)(3) provides that a consent may be filed not later than the due date of the corporation's income tax return for the taxable year for which the dividends paid deduction is claimed. Under Rev. Rul. 78-296, 1978-2 C.B. 183, the due date for purposes of § 1.565-1(b)(3) includes the extended due date of a return filed pursuant to an extension of the time to file.

Section 301.9100-1(c) provides that the Commissioner of Internal Revenue, in exercising his discretion, may grant a reasonable extension of time under the rules set forth in § 301.9100-3 to make a regulatory election under all subtitles of the Internal Revenue Code except subtitles E, G, H, and I. The term "regulatory election" is defined in § 301.9100-1(b) as an election whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, revenue procedure, or announcement published in the Internal Revenue Bulletin.

Section 301.9100-3(a) provides that requests for relief subject to this section will be granted when the taxpayer provides the 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.

Under Section 301.9100-3(b)(1)(i), except as provided in paragraphs (b)(3)(i) through (iii) of this section, a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer requests relief before the failure to make the regulatory election is discovered by the Service.

Paragraphs (b)(3)(i) through (iii) of § 301.9100-3 provide that a taxpayer is deemed to have not 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 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. If specific facts have changed since the due date for making the election that make the election advantageous

to a 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.

In the present case, relief was requested before the failure to make the regulatory elections properly was discovered by the Service. Further, the Funds are not seeking to alter a return position for which an accuracy-related penalty could have been imposed. Nor were the Funds informed of the required elections, but chose not to file the elections. Moreover, there is no indication that the Funds are using hindsight in requesting relief. Specific facts material to the issue under consideration have not changed since the due date for making the elections that make the elections advantageous to the Funds.

Section 301.9100-3(c)(1) 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 taxable years affected by the election than the taxpayer would have had if the election had been timely made. 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.

In this case, the Funds will not have a lower tax liability in the aggregate for any taxable year in which the elections apply than the Funds would have had if the elections had been made timely. Also, no taxable year that would be affected by the elections, had they been timely made, is closed by the period of limitations on assessment.

CONCLUSION

Based on the above, Fund 1 and Fund 2 are granted an extension of 45 days from the date of this letter within which they may:

- (1) Execute and file a Form 972 as to Fund 1;
- (2) Correct the amount of the § 565 election by filing an amended Form 972 as to Fund 2; and
- (3) Execute and file Forms 973.

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110 of the Internal Revenue Code.

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 directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

PAUL M. RITENOUR
Chief, Branch 1
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosures (2)

cc: