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Internal Revenue Service

Department of the Treasury

P.O. Box 7604
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Washington, DC 20044

CC:DOM:IT&A:5

Date: FEB 4 1999

Taxpayer	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
x	=
y	=
City Q	=
Sub R	=
Mr. S	=
Year 1	=
Year 2	=

Dear

This responds to your letter of July 23, 1998, and subsequent correspondence, requesting an extension of time, under §§ 301.9100-1 and -3 of the Procedure and Administration Regulations, for Taxpayer to make an election to use the alternative cost method of accounting in conformity with the requirements of Rev. Proc. 92-29, 1992-1 C.B. 748.

Taxpayer is a real estate developer. This request for relief concerns one development project. Pursuant to this revenue procedure, Taxpayer seeks to include in its basis with respect to each lot sold, the share of estimated costs of common improvements that is allocable to such lot, without regard to the economic performance test of § 461(h) of the Internal Revenue Code, in order to more accurately reflect the

costs incurred with respect to each lot sold in the development. Section 6 of Rev. Proc. 92-29 provides that if the taxpayer estimates the cost of common improvements using the "Ten-Taxable Year Horizon," the due date prescribed for making an election to use the alternative cost method is the due date of the taxpayer's original federal income tax return (determined with regard to extensions) for the taxable year in which the first benefitted property in the project is sold. Taxpayer uses the accrual method of accounting and accounts for income on a calendar year basis. The election under Rev. Proc. 92-29 for the tax year ending on Date 1 was due on Date 2. The failure to file the election was discovered on or about Date 3. Taxpayer filed for § 301.9100 relief from its failure to make a timely election under Rev. Proc. 92-29 on or about Date 4. Thus, a period of about x days elapsed between the date of discovery and the date of filing.

The development project is a residential subdivision comprising y finished lots in City Q. The name of the development is the Sub R. The common improvements consist of (1) paved roads, including curbs, gutters and sidewalks; (2) utilities, including storm drain, sanitary sewer and water lines; and (3) the construction or installation of certain off-site improvements, including a drainage structure, a major arterial street near to the subdivision and a traffic signal.

In Rev. Proc. 92-29, the Service provides a procedure for a real estate developer to obtain the Service's consent to use an alternative to the general method under § 461(h) for determining when improvement costs may be included in the basis of properties sold for purposes of determining the gain or loss resulting from the sales. Under this alternative ("alternative cost method"), a developer may include in basis of properties sold the allocable share of the estimated cost of common improvements without regard to whether the costs are incurred under § 461(h), subject to certain limitations. Among the general conditions for use of the provisions of Rev. Proc. 92-29 is the requirement that the developer timely file a request to use the alternative cost method on a project-by-project basis in accordance with the procedures set forth in section 6 of the revenue procedure. As it applies to Taxpayer, section 6.01 requires a developer to file a request with the district director for the internal revenue district in which is located the principal place of business or the principal office or agency. The request must be filed on or before the due date of the developer's original federal income tax return (determined with regard to extensions) for the taxable year in which the first property in the project is sold.

Taxpayer engaged the services of Mr. S, CPA, when it was formed as an S corporation in Year 1. This engagement included tax return preparation and miscellaneous accounting services. Taxpayer relied on Mr. S for such professional tax advice as was required. Pursuant to this engagement, Mr. S began accounting for costs of properties sold in the Sub R as properties first began to be sold in Year 2, in accordance with a method that is substantially the same as the alternative cost method

as set forth in Rev. Proc. 92-29. No representative of Taxpayer was aware of the requirement to make an election in the manner specified in Rev. Proc. 92-29 until this requirement was mentioned to Mr. S by an IRS revenue agent during the course of the audit of Taxpayer's Year 2 federal income tax return. Upon being so informed, Mr. S notified Taxpayer of this requirement.

Section 461(h)(1) of the Code provides that, in determining whether an amount has been incurred with respect to any liability during any taxable year, the all events test shall not be treated as met any earlier than the taxable year in which economic performance with respect to such liability occurs. Section 1.446-1(c)(1)(ii)(B) of the Income Tax Regulations provides that the term "liability" includes any item allowable as a deduction, cost, or expense for federal income tax purposes. In addition, the term also includes any amount otherwise allowable as a capitalized cost, as a cost taken into account in computing cost of goods sold, as a cost allocable to a long-term contract, or as any other cost or expense.

The enactment of § 461(h) changed the time for adding common improvement costs to the basis of property. In general, under § 461, common improvement costs may not be added to the basis of properties benefitted by those improvements until the common improvement costs are incurred within the meaning of § 461(h). Common improvement costs that have not been incurred under § 461(h) when benefitted properties are sold may not be included in the basis of the properties in determining the gain or loss resulting from the sales.

Rev. Proc. 92-29 sets up the procedure whereby taxpayers may elect to add the future costs of common improvements to properties as they are sold using the alternative cost method. In addition to the requirement that the election be timely, consent to use that method is generally conditioned on the following:

> (1) The developer must be contractually obligated or required by law to provide the common improvements, and the cost of the common improvements must not be properly recoverable through depreciation by the developer.
>
> (2) The developer must sign a consent extending the period of limitation on the assessment of income tax with respect to the use of the alternative cost method on a project-by-project basis as described in section 7 of the revenue procedure.
>
> (3) The developer must file an annual statement for each project for which the developer has received permission to use the alternative cost method in accordance with section 8 of the revenue procedure.

(4) The developer must file a supplemental request for each project for which the developer has received consent to use the alternative cost method, in accordance with the procedure set forth in section 9 of the revenue procedure, if the project is not completed within the time originally estimated when the consent was first obtained.

The regulation under § 301.9100-3 provides extensions of time for making regulatory elections that do not meet the requirements of § 301.9100-2. For this purpose, § 301.9100-1 defines the term "election" to includes a request to adopt, change or retain an accounting method, and the term "regulatory election" to include an election whose deadline is prescribed by a revenue procedure.

Section 301.9100-3(a) of the regulations provides, in part, that requests for relief will be granted when the taxpayer provides evidence (including affidavits) 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.

Section 301.9100-3(b)(1) of the regulations provides, in part, that except as provided in paragraphs (b)(3)(i) through (iii) of this section (as set forth below), a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional and the tax professional failed to make, or advise the taxpayer to make, the election.

The affidavits presented by Taxpayer in the present case make a prima facie showing of reasonableness and good faith on the part of Taxpayer because Taxpayer relied on a qualified tax professional, Mr. S, a CPA, on whom Taxpayer has relied since Year 1 to prepare its returns and provide tax advice.

Section 301.9100-3(b)(3) of the regulations provides, in part, 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 has been or could be imposed under § 6662 at the time the taxpayer requests relief (taking into account § 1.6664-2(c)(3) of this chapter) 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. In connection with hindsight, if specific facts have changed since the due date for making the election that make the election advantageous to the 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.

In the present case, Taxpayer is not seeking to alter its return position. Rather it

has computed its basis, as verified by the revenue agent, under a method that is substantially identical to the alternative cost method formally approved in Rev. Proc. 92-29. Taxpayer is only seeking to legitimize the use of this method by making the election as required in the revenue procedure. Also, Taxpayer was not informed until after the deadline for making the election that the election had to be made. Finally, there was no hindsight involved in Taxpayer's decision to request relief under § 301.9100-3 of the regulations because specific facts have not changed since the due date for making the election that make the election advantageous to the Taxpayer. Accordingly, we believe Taxpayer is acting reasonably and in good faith.

Section 301.9100-3(c)(1)(i) of the regulations provides, in part, 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 (taking into account the time value of money). Section 301.9100-3(c)(1)(ii) of the regulations provides, in part, that 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 the present case, Taxpayer will not have a lower tax liability in the aggregate for all the years in which the election would apply. This is especially evident in view of the fact that Taxpayer filed its return for Year 2 substantially using the alternative cost method, although without proper election. Furthermore, no taxable year that would be affected by the election, had it been timely made, is closed by the period of limitations on assessment.

Section 301.9100-3(c)(2) of the regulations provides, in part, that the interests of the government are deemed to be prejudiced, except in unusual and compelling circumstances, if the accounting method regulatory election for which relief is requested (i) is subject to the procedure described in § 1.446-1(e)(3) (requiring advance written consent of the Commissioner [through a formal application filed on Form 3115]); (ii) requires an adjustment under § 481(a) (or would require an adjustment under § 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); (iii) would permit a change from an impermissible method of accounting that is an issue under consideration by examination, an appeals office, 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) provides a more favorable method of accounting or more favorable terms and conditions if the election is made by a certain date or taxable year.

In the present case, Taxpayer is already substantially using the method described in Rev. Proc. 92-29 and the election to use this method is automatic. Thus, there is no requirement for advance written consent of the Commissioner, nor is any adjustment necessary pursuant to § 481(a) of the Code. Moreover, granting Taxpayer's request will not permit a change from an impermissible method of accounting that is an issue under consideration by examination because the method Taxpayer is now using is substantially the same method approved in Rev. Proc. 92-29. Finally, there is no indication that the regulatory election for which relief is requested provides a more favorable method of accounting or more favorable terms and conditions if the election is made by a certain date or taxable year. Therefore, the interests of the government will not be prejudiced if Taxpayer is permitted to make the election under Rev. Proc. 92-29.

In this case, Taxpayer has demonstrated that: (a) it acted reasonably and in good faith in relying on its professional tax advisor and is not using hindsight in requesting relief; and (b) granting relief will not prejudice the interests of the government. Furthermore, the time for making elections under Rev. Proc. 92-29 is not expressly prescribed by statute and Taxpayer's request for relief was filed within such time as the Commissioner considers reasonable under the circumstances.

Accordingly, the consent of the Commissioner is hereby granted Taxpayer, for the tax year ended on Date 1, to comply with the requirements of Rev. Proc. 92-29 for making the election to use the alternative cost method of accounting. This extension shall be for a period of 45 days from the date of this ruling. Please attach a copy of this ruling to the returns, schedules and forms filed in connection with making the election under Rev. Proc. 92-29 when such forms are filed.

No opinion is expressed as to the application of any other provision of the Code or the regulations which may be applicable under these facts. Pursuant to the power of attorney on file in this office, executed by Taxpayer on July 20, 1998, a copy of this ruling will be sent to Taxpayer. Section 6110(j)(3) of the Code provides that private letter ruling may not be used or cited as precedent.

Sincerely yours,

Assistant Chief Counsel
(Income Tax & Accounting)

by_____
Douglas Fahey, Assistant to the Branch Chief
Branch 5

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cc: (1) DD -
Attn: Chief, Examination Division

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