Internal Revenue Service

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Department of the Treasury
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Date:
February 25, 2021

In Re:

LEGEND

Taxpayer	=
Borrowers	=
Underwriter	=
Counsel	=
Business 1	=
Date 1	=
Date 2	=
Date 3	=
Taxable Year 1	=
Taxable Year 2	=
Taxable Year 3	=
Taxable Year 4	=
Taxable Year 5	=
Taxable Year 6	=
Taxable Year 7	=
Taxable Year 8	=
Taxable Year 9	=

Dear :

This letter responds to a letter dated Date 1, and supplemental correspondence, submitted by Counsel on behalf of Taxpayer. Taxpayer requests consent of the Commissioner of the Internal Revenue to revoke elections, made under section 1.263(a)-5(d)(4) of the Income Tax Regulations, to capitalize intercompany underwriting fees incurred by Taxpayer and another member of its consolidated group in connection with certain borrowings.

FACTS

Taxpayer represents that the facts are as follows:

Taxpayer is engaged in the business of Business 1 and is the common parent of an affiliated group of corporations that files a consolidated federal income tax return on a calendar-year basis. During the years at issue, all members of Taxpayer's consolidated group employed the overall accrual method of accounting.

Taxpayer inadvertently elected under section 1.263(a)-5(d)(4) to capitalize certain expenses in pursuit of various borrowings by Borrowers (members of Taxpayer's consolidated group) from Taxable Year 1 through Taxable Year 8.

The expenses in question are fees that Borrowers incurred and paid to Underwriter for conventional underwriting services performed by employees of Underwriter. Underwriter is a disregarded entity that is wholly owned by a member of Taxpayer's consolidated group. Underwriter acted as bookrunner and principal underwriter on Borrower's unsecured borrowings, and it received fees from Borrowers in connection with numerous borrowings during the years at issue.

The fees paid to Underwriter, like those paid to the unrelated underwriters that frequently participated in the same issuances, were ordinarily based on underwriting volume and maturity, and were consistent with standard market practice.

Taxpayer generally eliminates intercompany transactions for consolidated reporting under U.S. Generally Accepted Accounting Principles (GAAP). However, fees paid between different segments within Taxpayer's consolidated group are treated similar to transactions with a third party. Taxpayer's typical practice for underwriting activity is to apply GAAP as if each of its business segments were transaction with a third party. Therefore, for financial reporting purposes, Taxpayer capitalizes the underwriting fees and amortizes them over the life of the debt on a straight-line basis. The operation, which includes Underwriter, reports the fees as current revenue. This method of reporting accelerates the Taxpayer's consolidated group's financial

accounting income as a result of dealings that take place entirely within the Taxpayer's consolidated group, and the accelerated income is later reversed as the outlays are amortized. This method of reporting is not in accordance with GAAP but is tolerated for financial statement purposes if amounts involved are not large enough to affect the income of the reporting entity.

The accounting exception for capitalization of the intercompany underwriting fee expense was consistently approved by Taxpayer's controllers and the group responsible for corporate accounting policies, and external tax consultants. Taxpayer generally follows financial accounting treatment for tax purposes unless a reason for deviation is known and the corporate tax function of Taxpayer was not aware of the financial accounting treatment applied to intercompany underwriting fees. By following book treatment, Taxpayer has consistently capitalized underwriting expenses paid to Underwriter for tax purposes during the years at issue.

Taxpayer discovered the financial accounting treatment applied to intercompany underwriting fees as part of a broader tax review in or around February or March of Taxable Year 9, and members of the corporate tax function realized the financial accounting treatment of the intercompany underwriting fees presented significant tax issues. After further investigation, Taxpayer's tax staff became aware of the election in section 1.263(a)-5(d)(4) in late Taxable Year 9. By that time, it was too late to change the treatment of intercompany underwriting fees on the Taxable Year 8 consolidated tax return. The decision was made to seek consent to revoke the inadvertent elections that Taxpayer's group had made for Taxable Year 8 and earlier taxable years.

Borrowers continue to issue debt and incur similar fees. Starting in Taxable year 9, Taxpayer plans to currently deduct the underwriting fees paid by Underwriter. The revised treatment will match expense timing to fee revenue and better reflect the Taxpayer's consolidated group's income.

Taxpayer is seeking permission to revoke its inadvertent elections under section 1.263(a)-5(d)(4) for Taxable Years 1 through 8. For Taxable Year 1 and Taxable Years 4 through 8, the period of limitations on assessment and refund (including extensions) is open under section 6501(a) of the Internal Revenue Code as of the issuance date of this ruling letter. The periods of limitations on assessment and refund for Taxable Years 2 and 3 expired on Date 2 and Date 3, respectively. Taxpayer timely filed amended returns for Taxable Years 2 and 3 that include protective claims for refund or credit of any overpayments for those taxable years that would result in the event that the Taxpayer obtains the consent sought in this ruling request.

Subsequent to filing its ruling request, Taxpayer amended its request by withdrawing its request to revoke the election under section 1.263(a)-5(d)(4) for Taxable Years 4 through 6. Accordingly, Taxpayer's ruling request only relates to Taxable Years 1, 2, 3, 7 and 8.

LAW AND ANALYSIS

Section 1.263(a)-5(a) generally provides that a taxpayer must capitalize an amount paid to facilitate certain enumerated transactions.

Section 1.263(a)-5(a)(9) provides that a borrowing, including an issuance of debt, is a transaction covered under the general rule provided in section 1.263(a)-5(a).

Section 1.263(a)-5(d)(1) generally provides, in part, that employee compensation is treated as an amount that does not facilitate a transaction described in section 1.263(a)-5(a).

Section 1.263(a)-5(d)(4) provides that notwithstanding the general rule provided in section 1.263(a)-5(d)(1), a taxpayer may elect to capitalize employee compensation as amounts that facilitate a transaction. The election is made separately for each transaction and applies to employee compensation, overhead, or de minimis costs, or any combination thereof. The election is made by treating the amounts to which the election applies as amounts that facilitate the transaction in the taxpayer's timely filed original federal income tax return (including extensions) for the taxable year during which the amounts are paid. The election is revocable with respect to each taxable year for which it was made only with the consent of the Commissioner.

Section 1.263(a)-5(d)(2)(ii) provides that in the case of an affiliated group of corporations filing a consolidated federal income tax return, a payment by one member of a group to a second member of the group for services performed by an employee of the second member is treated as employee compensation if the services were provided at a time during which both members were affiliated.

Taxpayer has requested permission to revoke its elections under section 1.263(a)-5(d)(4) for Taxable Years 1, 2, 3, 7 and 8. Taxpayer's request to revoke its elections resulted from the Taxpayer's corporate tax function being unaware of the accounting exception for capitalization of the intercompany underwriting fee expense that was consistently approved and reviewed by Taxpayer's controllers and the group responsible for corporate accounting policies, and external tax consultants. This situation is analogous to those situations concerning taxpayers who have not made a particular election provided in the regulations because after exercising due 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, or because taxpayers received inadequate or incorrect advice from either an attorney or accountant knowledgeable in tax matters, and subsequently seek extensions of time under section

301.9100-1 of the Procedure and Administration Regulations in which to make the election.

Under section 301.9100-1, the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in sections 301.9100-2 and 301.9100-3 to make a regulatory election. Sections 301.9100-1 through 301.9100-3 provide the standards that the Commissioner will use to determine whether to grant an extension of time to make an election. Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides extensions of time for making elections that do not meet the requirements of section 301.9100-2.

Section 301.9100-3(a) provides that requests for relief under section 301.9100-3 will be granted when the taxpayer provides evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the Government. The application of similar factors is appropriate to determine whether taxpayers may revoke elections made under section 1.263(a)-5(d)(4).

Section 301.9100-3(a) provides that requests for relief under section 301.9100-3 will be granted when the taxpayer provides evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the Government.

Section 301.9100-3(b)(1) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer:

(i) Requests relief before the failure to make the regulatory election is discovered by the Service;
(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 Service; 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.

Section 301.9100-3(b)(2) provides that 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:

(i) Competent to render advice on the regulatory election; or
(ii) Aware of all relevant facts.

Section 301.9100-3(b)(3) provides that a taxpayer will be 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 section 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.

Section 301.9100-3(c)(1)(i) 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.

Section 301.9100-3(c)(1)(ii) provides 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 under section 6501(a) before the taxpayer's receipt of a ruling granting relief under this section. 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 under the standards set forth in section 301.9100-3(c)(1)(i).

CONCLUSIONS

1. Tax Years 1 through 3

The period of limitations for assessments are closed under section 6501(a) for Taxable Years 2 and 3. If relief is granted for Taxable Year 1, Taxable Years 2 and 3 would necessarily be impacted as amounts capitalized in those years would need to be reversed. In its request for relief Taxpayer has stated that it can make adjustments to its refund claim for Taxable Years 2 and 3 to the extent necessary to account for changes should the Taxpayer's request to revoke its election be granted.

However, as Taxable Years 2 and 3 are closed to review pursuant to section 6501(a), the IRS is legally barred from reviewing those taxable years and thus has no ability to ensure that any changes made pursuant to this ruling are made appropriately or not in a manner that is detrimental to the Government. As a result, Taxpayer has not overcome the "ordinarily prejudiced" standard set forth in section 301.9100-3(c)(1)(ii). Accordingly, we conclude that granting permission to revoke elections made under section 1.263(a)-5(d)(4) for Taxable Years 1 through 3 would prejudice the interests of the Government, and thus, permission is not granted for Taxpayer to revoke its elections under section 1.263(a)-5(d)(4) for Taxable Years 1 through 3.

On December 22, 2017, Public Law 115-97, 131 Stat. 2054, commonly referred to as the Tax Cuts and Jobs Act (TCJA) was enacted. TCJA lowered the U.S. federal income tax rate as applied to C Corporations from 35% to 21% for taxable years beginning after December 31, 2017. Taxpayer filed its U.S. federal income tax returns for Tax Years 1 – Tax Years 3 prior to the passage and enactment of TCJA. The decrease of the U.S. federal income tax rate from 35% to 21% constitutes a change in facts which makes the sought-after relief (the revocation of the election under section 1.263(a)-5(d)) advantageous to Taxpayer because tax deductions taken in tax years beginning before January 1, 2018 are generally worth 35% while those taken in tax years starting after December 31, 2017 are generally worth 21%. In such a case, taxpayers generally must provide "strong proof" that the decision to seek relief did not involve hindsight.

Because Taxpayer has not overcome the ordinarily prejudiced standard as discussed above, a detailed analysis of whether Taxpayer acted with hindsight with respect to Taxable Years 1 through 3 is not necessary.

Taxable Years 7 and 8

Based solely on the facts submitted and the representations made, we conclude that for Taxable Years 7 and 8, Taxpayer acted reasonably and in good faith, and that granting relief to revoke Taxpayer's elections under section 1.263(a)-5(d)(4) will not prejudice the interests of the Government. Taxpayer's internal accounting and tax staff and external tax consultants failed to identify the inadvertent capitalization election for federal tax purposes resulting from following capitalization for financial accounting purposes despite exercising reasonable diligence.

Accordingly, Taxpayer is granted 60 calendar days from the date of this letter to revoke its elections under section 1.263(a)-5(d)(4) for both Taxable Years 7 and 8. These revocations must be made in a written statement filed with Taxpayer's amended consolidated federal tax returns for Taxable Years 7 and 8. In addition, a copy of this letter must be attached to such amended consolidated federal tax returns. The amended consolidated federal income tax returns for Taxable Years 7 and 8 must include the adjustments to tax liability and adjustments to taxable income resulting from the deduction of intercompany underwriting fees rather than capitalization, and any collateral adjustments to taxable income or tax liability resulting from the revocations.

Additionally, Taxpayer must amend the consolidated federal income tax return for Taxable Year 9 and any other affected consolidated federal income tax returns to remove any amounts previously capitalized that will be deducted in Taxable Years 7 and 8 as a result of this ruling.

A copy of this letter ruling must be attached to any income tax return to which it is relevant. Alternatively, a taxpayer filing its return electronically may satisfy this requirement by attaching a statement to its return that provides the date and control number of the letter ruling.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal income tax consequences arising from the facts described above under any other provision of the Code or regulations. Specifically, no opinion is expressed or implied on whether any of the borrowings at issue are borrowings under section 1.263(a)-5(a), or whether the underwriting fee expenses at issue are properly deductible as employee compensation under section 1.263(a)-5(d)(1) or section 1.263(a)-5(d)(2)(ii).

The rulings contained in this letter are based on information and representations submitted by 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.
The rulings in this letter are directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the provisions of the power of attorney currently on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter to the appropriate operating division director.

Sincerely,

SUSIE K. BIRD
Senior Counsel, Branch 3
(Income Tax & Accounting)
Office of Chief Counsel

Enclosure: Copy for Section 6110 purposes

cc: