OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

May 26, 1999

CC:DOM:FS:IT&A
TL-N-7980-98

UILC: 1071.02-00
Number: **199937005**
Release Date: 9/17/1999

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: DEBORAH A. BUTLER, ASSISTANT CHIEF COUNSEL (FIELD SERVICE)
CC:DOM:FS

SUBJECT:

Field Service
Advice
Requirement and Manner of Election to Reduce Basis

This Field Service Advice responds to your undated memorandum, received here on March 1, 1999. It is not binding on Examination or Appeals and is not a final case determination. This document may not be cited as precedent.

LEGEND:

Taxpayer	=	.
A	=	
B	=	
C	=	
Year 1	=	
Year 2	=	

ISSUE:

Whether Taxpayer may reduce its basis in other property under I.R.C. § 1071 and Treas. Reg. § 1.1071-2(a)(3) in the absence of a prior election to do so.

CONCLUSION:

Taxpayer may not reduce its basis in other property.

FACTS:

Taxpayer was the parent corporation of a group including A, B, and C. During Year 1 and Year 2, each of A, B and C sold certain assets. By invoking the right under section 1071 to treat the sales as involuntary conversions under section 1033(a), all three elected to defer the gain realized on the conversion by replacing the property sold with qualified replacement property within the prescribed two-year time period. This election was made on a statement attached to the tax returns for the years of the sales. Each of the three possessed the written certificate from the Federal Communications Commission (FCC) at the time of filing their return. None of the three opted to reduce their basis in other assets in any of their respective elections; nevertheless, having failed to replace the converted property within the requisite time period, Taxpayer apparently seeks now to reduce the basis of other depreciable property held in the years of sales.

LAW AND ANALYSIS:

Now-repealed section 1071 provided that a taxpayer could treat the sale of certain broadcasting assets as an involuntary conversion if that sale were certified by the FCC to be necessary or appropriate to effectuate a change in policy of the FCC.[1]

[1] Section 1071, first enacted in substance in the Revenue Act of 1943 (Pub. Law 78-235, § 123), was originally intended as a wartime tax-relief provision for those market-limiting station sales that were ordered by the FCC, since acquisition of any new radio property during that time would have been difficult. See S. Rep. No. 78-627, at 23 (1943). Section 1071 was repealed by Pub. Law 104-97, § 2, 109 Stat. 93 (1995), generally, for sales and exchanges made on or after January 17, 1995. According to the House of Representatives' report, the section was repealed because of "serious tax policy problems." H.R. Rep. No. 104-32, at 16. Those problems included the FCC's progressive loosening of the standards for issuing tax certificates so as to go "far beyond" what Congress had originally contemplated as well as an FCC program that

A taxpayer entitled to the benefits of the section was allowed to elect one of the three options in Treas. Reg. § 1.1071-2(a)(3):

> (i) To treat such sale or exchange as an involuntary conversion under the provisions of section 1033; or,
>
> (ii) To treat such sale or exchange as an involuntary conversion under the provisions of section 1033, and in addition elect to reduce the basis of property . . . by all or part of the gain that would otherwise be recognized under section 1033; or
>
> (iii) To reduce the basis of property . . . by all or part of the gain realized upon the sale or exchange.

All three entities had elected the first option above with their returns; thus, in short, they had two years within which to acquire replacement property. In this case, Rev. Rul. 88-39, 1988-1 C.B. 299, sets out the controlling Service position. Specifically, a taxpayer who elected the provisions of section 1033 pursuant to section 1071(a) on a timely filed return and subsequently was unable to acquire qualified replacement property within the time prescribed by section 1033(a) may not later elect to reduce the basis of other depreciable property pursuant to Treas. Reg. § 1.1071-2(a). See also Rev. Rul. 79-277, 1979-2 C.B. 300 (election may not be made on an amended return).[2]

CASE DEVELOPMENT, HAZARDS, AND OTHER CONSIDERATIONS:

As you note, in Cloutier v. United States, 709 F.2d 480 (7th Cir. 1983), the court agreed with the Service position (see Rev. Rul. 79-277) that an election pursuant to section 1071 may not be made on an amended return. In dicta, however, the

---

was "so vague as to be subject to significant abuse." Id. Additionally, there was inadequate oversight by the IRS, or any other government body, with respect to the tax cost; thus, there was inordinate discretion conveyed to the FCC, resulting in "an open-ended entitlement program with no constraints" limiting the utilization of the provision. Id. at 16-17

[2] Compare Park Broadcasting v. Commissioner, 78 T.C. 1093 (1982), where an election made on an amended return was held valid because the taxpayer had not received FCC certification (and had not expected it because of FCC policy at the time) until well over four years after the year-of-sale return had been filed. Only later, after a change in FCC policy, the taxpayer took the opportunity to seek FCC certification and to make the deferral election.

court goes on to elucidate its view that a taxpayer making a section 1071 election to defer the gain under section 1033 who is unable to find replacement property within the prescribed time could change its election and instead defer any gain by reducing basis in other depreciable property in accordance with the regulations. 709 F.2d at 484-85. See Treas. Reg. § 1.1071-3. The Service expressly disagrees with the Cloutier dicta and formally establishes that opposition in Rev. Rul. 88-39, 1988-1 C.B. 299.

Regardless of the positions in Rev. Rul. 79-277 and Rev. Rul. 88-39, however, an inherent Service-adverse consideration may be that neither the statute nor the regulations indicate whether the election may be made via a timely amended return. The regulation governing the manner of election, Treas. Reg. § 1.1071-4(a), does not narrowly limit the time within which a valid election must be made. It provides only that "[a]n election under section 1071 must be filed with the return for the taxable year in which the sale or exchange occurs." The language "filed with the return" is not, however, specifically limited to the original return.

This was the focal point of Metzger v. United States, 82-2 U.S.T.C. ¶ 9446 (So. D. Ind.) There, although the return for the year of sale did not report gain or include a statement of election under section 1071, all details regarding the replacement of the converted property (as well as issuance of the FCC certificate) were unknown at the time of the filing of the original return. In addition, the court noted that securing a ruling from the Service and a certificate from the FCC was a "time consuming and complex process." The court held, therefore, that an election under section 1071 made with an amended return that was filed within the statute of limitations was timely. It characterized the Commissioner's position that an effective election could not be made by amended return to be "a hypertechnical one" and one of "form over substance." The court also dismissed the contention that by not making an affirmative election and leaving open its options a taxpayer will take advantage of the statute of limitations with the benefit of hindsight. On that point, the court said it was "simply not the case before [it]." That would presumably mean that such a case could be established in other circumstances. If that is now the case with Taxpayer here would obviously require significant further factual development.

Taxpayer may thus argue that the taxable year in issue was still open and its attempt to change an election as part of an amended return was arbitrarily and improperly rejected–perhaps even "hypertechnically" so. We would revisit in a new forum essentially the same arguments made by taxpayers in the Metzger and Cloutier cases. Under those circumstances, the need for Rev. Ruls. 79-277 and 88-39 to correct the omission of the regulations would probably be used by Taxpayer to highlight the uncertainty inherent in those regulations.

There is at least one significant difference here, however, which weighs heavily in favor of the Service. Taxpayer did make an actual election with its original return in this case, unlike those in Metzger and Cloutier. Under the regulations, that election "shall be irrevocable and binding." Treas. Reg. § 1.1071-2(a)(3). Thus, neither this taxpayer, nor any taxpayer, should be able to revoke its binding election by merely purporting to amend rightfully the earlier return upon which that election was made.

[redacted]

By: _____
THOMAS D. MOFFITT
Senior Technician Reviewer
Income Tax & Accounting Branch