

Internal Revenue Service

Department of the Treasury

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Date:
December 18, 2001

Legend:

Trust D
Trust E
Trust F
Husband
Wife
Corp A
Corp B
Firm
Year 1
Year 5

Dear _____ :

This is in reply to your letter of July 6, 2000, in which you requested a ruling that Corp A be allowed to make a retroactive election under Treas. Reg. §1.1295-3(f) for Year 1 with respect to Corp B. Additional information was submitted on June 22, 2001 and November 2, 2001.

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.

Corp A is a U.S. limited liability company that was formed in Year 1 to hold shares of Corp B. Corp A is equally owned by three complex trusts: Trust D, Trust E, and Trust F. Each of these trusts was formed for the benefit of one of the three children of

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Husband and Wife.

In Year 1, Husband and Wife transferred to Corp A their rights to buy common stock in Corp B. In Year 1, Corp A exercised those rights and acquired approximately ten percent of the common stock of Corp B. Corp B is a foreign corporation that has been a PFIC, within the meaning of section 1297(a), during Corp A's entire period of ownership. For the years at issue, Corp A's pro rata share of Corp B's ordinary earnings and net capital gain, within the meaning of section 1295, was zero.

Firm, a law firm specializing in domestic and international tax law, did the legal and administrative work involved in the formation of Corp A. Firm had access to all the relevant information concerning Corp A's assets, including its ownership of Corp B stock. Husband and Wife, their children, the trustees of Trusts D, E, and F, and Corp A relied upon Firm to advise them regarding the international aspects of U.S. tax law as applicable to Corp A, including the consequences of making or failing to make available elections. Firm failed to identify Corp B as a PFIC, and failed to advise of the consequences of Corp A making, or failing to make, the section 1295 election.

In Year 5, Wife was alerted by an independent advisor to the possibility that Corp B was a PFIC. Wife informed Firm of this concern, which subsequently verified that Corp B was a PFIC. Corp A then requested the Commissioner's consent to retroactively elect QEF treatment with respect to the stock it owned in Corp B. Neither Corp A, Husband and Wife, their children, nor any trustees of Trusts D, E, and F were aware, until Year 5, that Corp B was a PFIC.

The PFIC status of Corp B has not been raised by the Internal Revenue Service on audit for any taxable year of Corp A.

A PFIC will be treated as a qualified electing fund (QEF) with respect to a taxpayer if the taxpayer makes a valid QEF election under section 1295. A taxpayer that elects QEF treatment includes in gross income his pro rata share of the ordinary earnings and net capital gain of the QEF for the taxable year. A QEF election applies to the taxable year for which it is made and all subsequent taxable years unless revoked by the taxpayer with the consent of the Secretary. Section 1295(b)(1). A QEF election may be made on or before the due date (determined with regard to extensions) for filing the return for such taxable year. To the extent provided in regulations, a QEF election may be made after such due date if the taxpayer failed to make an election by the due date because the taxpayer reasonably believed the company was not a PFIC. Section 1295(b)(2).

Treas. Reg. §1.1295-3 provides rules for making a retroactive QEF election. Under these regulations, a shareholder of a PFIC that meets certain conditions may make a retroactive election without obtaining the consent of the Commissioner. Treas. Reg. §1.1295-3(b) or (e). Corp A has not met these conditions. A shareholder may also

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make a retroactive QEF election with the Commissioner's consent if it meets the requirements of Treas. Reg. §1.1295-3(f).

The Commissioner will grant relief under Treas. Reg. §1.1295-3(f) only if four requirements are satisfied. Treas. Reg. §1.1295-3(f)(1)(i)-(iv). The first requirement is that the shareholder reasonably relied on a qualified tax professional who failed to identify the foreign corporation as a PFIC or failed to advise the shareholder of the consequences of making, or failing to make, a section 1295 election. Treas. Reg. §1.1295-3(f)(2) provides that a shareholder will not be considered to have reasonably relied upon a qualified tax professional if the shareholder knew, or reasonably should have known, that the foreign corporation was a PFIC and knew of the availability of a section 1295 election. In addition, a shareholder cannot claim reliance upon a tax professional that the taxpayer knew, or reasonably should have known, was not competent to render tax advice with respect to stock ownership of a foreign corporation or did not have access to all relevant facts and circumstances.

Husband and Wife, their children, the trustees of Trusts D, E, and F, and Corp A relied upon Firm for advice concerning international aspects of U.S. taxation pertaining to Corp A, including the consequences of making or failing to make all available elections. Until Year 5, neither Corp A, Husband and Wife, their children, nor the trustees of Trusts D, E, and F knew that Corp B was a PFIC or that a section 1295 election was available, and Firm did not inform them about this election. Firm was competent to render tax advice with respect to stock ownership of a foreign corporation and had access to all the relevant facts and circumstances. Thus, Corp A reasonably relied on a qualified tax professional within the meaning of Treas. Reg. §1.1295-3(f)(1)(i) and (2).

The second requirement of Treas. Reg. §1.1295-3(f) is that granting consent will not prejudice the interests of the United States government. Under Treas. Reg. §1.1295-3(f)(3)(i), the interests of the U.S. government are prejudiced if granting relief would result in the shareholder having a lower tax liability, taking into account applicable interest charges, in the aggregate for all years affected by the retroactive election (other than by a de minimis amount) than the shareholder would have had if the shareholder had made the section 1295 election by the election due date. The time value of money is taken into account for purposes of this computation. Because Corp A would have had no income inclusion for the years in question under section 1293 if it had made a timely QEF election for those years, the interests of the U.S. government will not be prejudiced by allowing Corp A to make a retroactive section 1295 election.

The third requirement for making a special consent election under Treas. Reg. §1.1295-3(f) is that the request must be made before a representative of the Internal Revenue Service raises upon audit the PFIC status of the corporation for any taxable year of the shareholder. Corp A has requested consent under these special consent provisions before the issue has been raised on audit.

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The final requirement for making a special consent election is that the procedural requirements set forth in Treas. Reg. §1.1295-3(f)(4) must be met. Affidavits meeting these requirements and describing Firm's failure to inform Corp A of its need to make a QEF election have been submitted. Corp A has therefore met the procedural requirements of Treas. Reg. §1.1295-3(f)(4).

Based on the information submitted and representations made, consent will be granted to allow Corp A to make a retroactive election under Treas. Reg. §1.1295-3(f) for its Year 1 taxable year, provided Corp A complies with the rules under Treas. Reg. §1.1295-3(g) regarding the time and manner for making the retroactive QEF election.

A copy of this letter must be attached to any income tax return to which it is relevant.

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 ruling is forwarded to the taxpayer and its second representative.

Sincerely,
Valerie Mark Lippe
Senior Technical Reviewer
CC:INTL:BR2