

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:INTL:B02 – PLR-124796-02

Date:
October 09, 2003

In Re:

DO: TY:

LEGEND:

Accountant =
Attorney =

Country A =

Fund =
Fund Management =

Grantor Trust =

Husband =

PFIC 1 =
PFIC 2 =
PFIC 3 =

Taxpayers =

Wife =

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Dear _____ :

This is in response to a letter dated April 23, 2002, supplemented and corrected by information submitted on June 19, 2002, October 2, 2002, January 30, 2003 and April 11, 2003, requesting consent, under Treasury Regulation section 1.1295-3(f), to make retroactive qualified electing fund ("QEF") elections to treat the stock directly and indirectly owned by Taxpayers in each passive foreign investment company ("PFIC") listed below as stock in a QEF effective as of the first taxable year Taxpayers owned such stock.¹

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.

FACTS AND REPRESENTATIONS:

In connection with their private letter ruling request, Taxpayers have represented the following facts.

Taxpayers are married and file a joint Federal income tax return as calendar-year, cash-basis taxpayers. Taxpayers are grantors of Grantor Trust, a U.S. Trust. Taxpayers are treated as owners of Grantor Trust under sections 671 through 678.

In 1999, Grantor Trust acquired an interest in PFIC 1, a passive foreign investment company. During the years at issue, Grantor Trust also held an interest in Fund, a Country A limited partnership fund. In 1998, Fund acquired an interest in two PFICs, PFIC 2 and PFIC 3. PFIC 1, PFIC 2 and PFIC 3 are not controlled foreign corporations (CFCs) within the meaning of sections 951 through 964 of the Internal Revenue Code ("Code").

Taxpayers were advised by Attorney, prior to his retirement in 2001, regarding various tax matters, including the tax consequences of their investments. Attorney specialized in tax law. While representing Taxpayers, Attorney was aware that Taxpayers and Limited Partnership were investing in foreign corporations either directly,

¹ All section references are to the Internal Revenue Code of 1986 or the corresponding Treasury regulations thereunder.

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or indirectly, through investments in foreign limited partnership funds. However, Attorney failed to examine whether some such foreign corporations were PFICs, and as a result, Attorney failed to advise Taxpayers of the possibility of making, or the consequences of failing to make, a QEF election.

In addition to Attorney, Taxpayers relied on Accountant since 1995 to prepare their Federal income tax returns and the Federal income tax returns for Limited Partnership, including matters such as the tax consequences of making or failing to make QEF elections. Although Accountant was aware that Taxpayers invested in various investment funds, Accountant was unaware that these funds invested in PFICs, and as a result, did not advise Taxpayers of the possibility of making, or the consequences of failing to make, a QEF election.

Taxpayers have submitted affidavits executed by Attorney and Accountant which reflect the above statements concerning their failures to advise Taxpayers of the possibility of making, or the consequences of failing to make, QEF elections.

Taxpayers first became aware that they might own stock in PFICs in April 2001 upon receiving notification from Fund Management that it was investigating whether the funds in which Taxpayers and their family members invested included corporations that are PFICs. In July of 2001, Fund Management sent Taxpayers confirmation that they owned stock in PFICs.

RULING REQUESTED:

Taxpayers request the consent of the Commissioner of Internal Revenue to make retroactive QEF elections under Treas. Reg. § 1.1295-3(f) to treat PFIC 1, PFIC 2 and PFIC 3 as a QEF effective as of the first taxable year in which they owned stock such PFIC.

LAW AND ANALYSIS:

Section 1295(a) provides the general rule that any PFIC shall be treated as a QEF with respect to the taxpayer provided (1) an election by the taxpayer under section 1295(b) applies to such company for the taxable year, and (2) the company complies with requirements that the Secretary may prescribe for purposes of determining the ordinary earnings and net capital gain of such company, and otherwise carrying out the purposes of Subpart B ("Treatment of Qualified Electing Funds").

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Treas. Reg. § 1.1295-1(d)(2)(iii)(A)(2) provides that a U.S. person that is treated under sections 671 through 678 as the owner of a portion of a domestic trust that owns an interest in stock of a PFIC makes the section 1295 election with respect to that PFIC.

Section 1295(b)(1) provides that a taxpayer may make a QEF election with respect to a PFIC for any taxable year of the taxpayer. Treas. Reg. § 1.1295-1(c)(2)(i) provides that a foreign corporation with respect to which a section 1295 election is made will be treated as a QEF for its taxable year ending with or within the shareholder's election year and all subsequent taxable years of the foreign corporation that are included wholly or partly in the shareholder's holding period (or periods) of stock of the foreign corporation.

Section 1295(b)(2) states that an election may be made for any taxable year at any time on or before the due date (determined with regard to extensions) for filing the return of the tax imposed by Chapter 1 for such taxable year ("election due date"). To the extent provided in regulations, an election may be made later than the election due date where the taxpayer fails to make a timely election because the taxpayer reasonably believed the company was not a PFIC ("retroactive election").

Treas. Reg. § 1.1295-3(f) provides that a shareholder may request the consent of the Commissioner to make a retroactive election if the shareholder satisfies the following requirements:

- (1) the shareholder reasonably relied on a qualified tax professional;
- (2) granting consent will not prejudice the interests of the United States government;
- (3) the shareholder requests consent before a representative of the Internal Revenue Service raises upon audit the PFIC status of the corporation for any taxable year of the shareholder; and
- (4) the shareholder satisfies all procedural requirements set forth in Treas. Reg. § 1.1295-3(f)(4).

As provided in Treas. Reg. § 1.1295-3(f)(2), a shareholder is deemed to have reasonably relied on a qualified tax professional only if 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 QEF election. The section further states that a shareholder will not be considered to have reasonably relied on a qualified tax professional if the shareholder knew, or reasonably should have known, that the foreign corporation was a PFIC and of the availability of a section 1295 election, or knew or reasonably should have known that the qualified tax professional was not competent to render tax advice with respect

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to ownership of shares of a foreign corporation or did not have access to all relevant facts and circumstances.

In the present case, Taxpayers relied upon Attorney for advice on various tax matters, including the tax consequences of foreign investments. Taxpayers also relied upon Accountant for their federal income tax return preparation, including the consequences of making or failing to make available elections, such as a QEF election. Taxpayers were not tax professionals, and were unaware that the foreign corporations in which they invested, directly or indirectly, were PFICs until it was brought to their attention in 2001. Attorney and Accountant were competent to render tax advice with respect to stock ownership in a foreign corporation, but did not identify the foreign corporations in which Taxpayers invested indirectly as PFICs, or inform Taxpayers of the availability of a QEF election. Taxpayers 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)(1) states that the Commissioner may grant consent to a taxpayer to make a retroactive election only if granting consent will not prejudice the interests of the United States government. Treas. Reg. § 1.1295-3(f)(3)(i) provides that the interests of the United States government are prejudiced if granting the request 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 QEF election by the election due date, taking into account the time value of money for purposes of the computation. If granting relief would prejudice the interests of the United States government, the Commissioner may, in his sole discretion, grant consent to make a retroactive election, provided the shareholder enters into a closing agreement with the Commissioner that requires the shareholder to pay an amount sufficient to eliminate any prejudice to the government as a consequence of the shareholder's inability to file amended returns for the closed taxable years. Treas. Reg. § 1.1295-3(f)(3)(ii). In the present case, it has been determined that granting relief will not prejudice the interests of the United States government.

The third requirement to be met under Treas. Reg. § 1.1295-3(f)(1) 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. Taxpayers represent that they made the request for consent to make retroactive QEF elections before the issue was raised on audit.

The final requirement for a retroactive election under Treas. Reg. § 1.1295-3(f)(1) is that the procedural requirements set forth in Treas. Reg. § 1.1295-3(f)(4) must be met. The procedural requirements set forth include filing a request for consent to make

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a retroactive election and appropriate user fee with the Office of the Associate Chief Counsel (International). Treas. Reg. § 1.1295-3(f)(4)(i). Additionally, affidavits signed under penalties of perjury must be submitted by the shareholder and any qualified tax professional upon whose advice the shareholder relied. Treas. Reg. § 1.1295-3(f)(4)(ii) and (iii). These affidavits must describe the events that led to the failure to make a QEF election by the election due date, the discovery of such failure, and the engagement and responsibilities of the qualified tax professional and the extent to which the shareholder relied on such professional. Taxpayers have submitted affidavits meeting the requirements set forth in Treas. Reg. § 1.1295-3(f) describing the failures of Attorney and Accountant to inform Taxpayers of the need to make QEF elections. Taxpayers have submitted the appropriate user fee. Therefore, Taxpayers have met the procedural requirements of Treas. Reg. § 1.1295-3(f)(4).

Based on the information submitted and the representations made, Taxpayers are granted consent to make retroactive QEF elections under Treas. Reg. § 1.1295-3(f) with respect to their direct ownership in PFIC 1, effective for their 1999 taxable year, and with respect to their indirect ownership in PFIC 2 and PFIC 3, effective for their 1998 taxable year, provided Taxpayers comply with rules under Treas. Reg. § 1.1295-3(g) regarding the time and manner for making a retroactive QEF election.

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

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Taxpayers.

Sincerely,

Valerie A. Mark Lippe
Senior Technical Reviewer, Branch 2
Office of Associate Chief Counsel
(International)

cc: