Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:INTL:Br2, PLR-113916-00

In Re:

Date:
March 2, 2003

LEGEND:

Trust A =

Trust B =

Trust C =

Corp A =

Corp B =

Corp C =

Partnership A =

Partnership B =

Partnership C =

Individual A =

Individual B =

Individual C =

Individual D =

Individual E =

Individual F =

Individual G =

Individual H =

Individual I =

Firm A =
FP =
FC1 =
FC2 =
FC3 =
FC4 =
FC5 =
FC6 =
FC7 =
Year 1 =

Dear :

This private letter ruling is in response to your request dated June 6, 2000, for a determination that Trusts A through C, domestic trusts, Corps A through C, domestic corporations, Partnerships A and C, domestic partnerships, and Individuals A through I, U.S. citizens or residents, (hereinafter collectively referred to as "Taxpayers") are eligible to make retroactive elections to treat certain investments in passive foreign investment companies (PFICs) as qualified electing funds (QEFs) pursuant to Treas. Reg. § 1.1295-3.

The rulings contained in this letter are based upon information and representations submitted by Taxpayers, and accompanied by a penalty of perjury statement executed by an appropriate party.

Trusts A through C, Corps A and B, and Partnerships A and C are limited partners of FP, a limited partnership organized, in Year 1, under the laws of Bermuda. Corp C and Individuals A through F are shareholders of FC 7, a PFIC that is a limited partner of FP. Individuals G through I are partners of Partnership B, a foreign partnership that is a limited partner of FP.

During Year 1, FP acquired the stock of three foreign corporations (FC1, FC2 and FC3) that are treated as PFICs under section 1297(a).[1] Under section 1298(a)(2) and (3),

[1] Pub.L. No. 105-34, Sec. 1121, (1997) redesignated the provisions contained under section 1296 of the Code as section 1297, effective as of August 5, 1997. For purposes of this document, the former section 1296 will be referred to herein as section 1297.

Taxpayers are indirect shareholders of FC1, FC2 and FC3. For taxable year ended December 31, Year 1, FP elected to treat FC1, FC2 and FC3 as QEFs and filed a Form 8621 for each respective entity with FP's U.S. partnership income tax return. FP also attached the PFIC annual information statements for FC1, FC2 and FC3 to Forms 8621 for such taxable year. No QEF elections were made by Taxpayers with respect to FC1, FC2 and FC3 for taxable year ended December 31, Year 1.

Taxpayers and FP have represented that the items of income and gain reported by FP to its partners on the Schedules K-1 for the Year 1 taxable year included the ordinary earnings and net capital gain of FC1, FC2 and FC3. However, the items of income and gain reported on the Schedules K-1 did not specifically identify that such amounts included ordinary earnings and net capital gain earned from PFICs.

During Year 1, FC3 acquired the stock of three foreign corporations (FC4, FC5 and FC6) that are treated as PFICs under section 1297(a). Through its direct ownership of FC3, FP is an indirect shareholder of FC4, FC5 and FC6. Section 1298(a)(2). Hence, Taxpayers are also indirect shareholders of FC4, FC5 and FC6. Neither Taxpayers nor FP filed a Form 8621, with respect to their indirect ownership of FC4, FC5 and FC6, to elect QEF status for such entities for Year 1.

Taxpayers have represented that for taxable year ended December 31, Year 1, the items of income and gain reflected in the ordinary earnings and net capital gain of FC3, and reported by FP to its partners on the Schedules K-1, included the ordinary earnings and net capital gain of FC4, FC5 and FC6. The schedules K-1, however, did not specifically identify that such amounts included ordinary earnings and net capital gain earned from PFICs.

Firm A was FP's tax advisor and U.S. income tax return preparer for taxable year ended December 31, Year 1. Firm A was competent to render U.S. tax advice with respect to stock ownership in foreign corporations, and prepared FP's U.S. partnership return of income (Form 1065) and the Schedules K-1 for FP's partners for Year 1. Firm A had access to all relevant facts, including financial information, regarding FP's investments in FC1 through FC6.

FP and Taxpayers relied on the tax services and advice provided by Firm A. FP did not notify Taxpayers that it made investments, directly or indirectly, in foreign corporations that were PFICs. Although Firm A possessed all relevant facts and financial information about FC1 through FC6, it did not advise Taxpayers of the consequences of making, or failing to make, the section 1295 QEF election. Furthermore, the items of income and gain reported on Taxpayers' Schedules K-1 did not specify that such amounts included ordinary earnings and net capital gain earned from PFICs.

A U.S. person that owns stock in a PFIC may elect, under section 1295, to treat the PFIC as a QEF. Pursuant to this election, the U.S. person must include in gross income its pro rata share of the ordinary earnings and net capital gain of the QEF for the taxable year. Section 1293(a).

The QEF election may be made only by the first U.S. person in a chain of ownership from the PFIC. *See* Notice 88-125, 1988-2 C.B. 535 (applicable to taxable years prior to January 1, 1998). Thus, if a U.S. person holds an interest in a foreign partnership that holds an interest in a PFIC, the QEF election is made by the U.S. person.

Generally, a taxpayer makes the QEF election by attaching a Form 8621 to a timely filed income tax return for the taxable year to which the election applies. *See* Notice 88-125, 1988-2 C.B. 535. However, in certain circumstances, a taxpayer may make the QEF election retroactively. Treas. Reg. § 1.1295-3(f)(1) sets forth the requirement for making a retroactive QEF election by special consent. Treas. Reg. § 1.1295-3(f) provides that the Commissioner will grant a retroactive QEF election only if:

> (i) The shareholder reasonably relied on a qualified tax professional, within the meaning of [Treas. Reg. § 1.1295-3(f)(2)];
>
> (ii) Granting consent will not prejudice the interests of the United States government, as provided in [Treas. Reg. § 1.1295-3(f)(3)];
>
> (iii) The shareholder requests consent under [Treas. Reg. §1.1295-3(f)] 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
>
> (iv) The shareholder satisfies the procedural requirements set forth in [Treas. Reg. § 1.1295-3(f)(4)].

Treas. Reg. § 1.1295-3(f)(2) provides that reasonable reliance on a qualified tax professional includes circumstances in which

> 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, the section 1295 election. A shareholder will not be considered to have reasonably relied on a qualified tax professional if the shareholder knew, or 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 —
>
> (A) Was not competent to render tax advice with respect to the ownership of shares of a foreign corporation; or
>
> (B) Did not have access to all relevant facts and circumstances.

Treas. Reg. § 1.1295-3(f)(3)(i) defines the circumstances that would result in prejudice to the interests of the United States government:

The interests of the United States 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.

FP attempted to make the QEF election for FC1, FC2 and FC3 for the Year 1 taxable year. However, as a foreign person, FP is not entitled to make the QEF election. Rather, the QEF election should have been made by the first U.S. person that is the direct or indirect shareholder of FC1 through FC6, and thus, the elections should have been made by Taxpayers. Although Taxpayers failed to make timely QEF elections, they may request the consent of the Commissioner to make retroactive QEF elections, under Treas. Reg. § 1.1295-3(f), for FC1 through FC6, effective for taxable year ended December 31, Year 1.

In this case, Taxpayers relied on the professional tax services of Firm A. Firm A had all relevant facts and financial information concerning FC1 through FC6, and knew that such entities were PFICs. Firm A did not inform Taxpayers that FC1 through FC6 were PFICs, and of the availability, or consequences, of making the QEF elections. Rather, Firm A reported the ordinary earnings and net capital gain of FC1 through FC6 in Taxpayers' Schedules K-1 without identifying that such amounts related to income and gain earned from PFICs. Therefore, Taxpayers were not aware that FP had invested in foreign corporations that were PFICs, or that they could have made QEF elections with respect to such investments.

Taxpayers represent that they have reported on their respective returns, for the tax years at issue, the proper amount of ordinary earnings and net capital gain of FC1 through FC6. To support this representation, Taxpayers have provided tax return information to the Commissioner for review. Based upon this review, the Commissioner is satisfied that granting consent to make retroactive QEF elections would not prejudice the interests of the U.S. government.

No representative of the Internal Revenue Service has raised upon audit the PFIC status of FC1 through FC6 for any taxable year in which FP held the stock in such foreign corporations. Further, Taxpayers have satisfied the procedural requirements of Treas. Reg. § 1.1295-3(f)(4).

Based on the facts herein, Taxpayers are granted consent to make retroactive section 1295 QEF elections with respect to their indirect ownership in FC1, FC2, FC3, FC4, FC5 and FC6, effective for the Year 1 taxable year. Taxpayers shall comply with the rules under Treas. Reg. § 1.1295-3(g) regarding the time and manner for making the retroactive QEF election.

This private letter ruling does not express an opinion about whether FP or Taxpayers properly complied with the section 1295 annual reporting requirements, or the section

1293 annual income inclusions, with respect to FC1 through FC6 for taxable years ended after Year 1.

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

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

In accordance with the power of attorney on file with this office, a copy of this ruling is forwarded to Taxpayers and their second representative.

Sincerely,

By: _____

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

cc: