Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Date:
October 08, 2003

DO: TY:

LEGEND

Accounting Firm =
Accountant =

Bookkeeper =

PFIC 1 =
Foreign Corp =

Partner 1 =
Partnership =

State A =

Dear :

This letter is in response to a letter dated February 10, 2003, supplemented by information submitted on March 19, 2003 and July 9, 2003, requesting the consent of the Commissioner of Internal Revenue to make a retroactive qualified electing fund ("QEF") election under section 1295 of the Internal Revenue Code ("Code") and corresponding Treasury regulation section 1.1295-3(f).

FACTS:

In connection with the private letter ruling request, Partnership has represented the following facts:

Partnership, formed as a limited liability company under State A law, is organized as a partnership for U.S. federal income tax purposes. Partnership provides financial services consulting and invests in certain types of companies that are determined by its partners, based on their finance experience, to have growth potential.

On October 19, 1999, Partnership acquired shares of PFIC 1. At this time, Partnership was not aware that PFIC 1 was a PFIC. From 1999 through 2001, PFIC 1's only asset was stock in Foreign Corp. To authorize the indirect investment in Foreign Corp, the partners in Partnership executed a special amendment to the Partnership operating agreement. The amendment executed by the partners described the transaction as an acquisition of the shares of Foreign Corp without making any reference to PFIC 1. Partner 1 was the named shareholder of record for Partnership's investment.

Partnership engaged Accounting Firm to prepare its U.S. partnership income tax return, to advise on income tax issues and to make all applicable federal tax elections. Accountant, a tax partner at Accounting Firm, annually prepared Partnership's income tax return. For the tax year in issue, Bookkeeper, an employee of Partnership, provided Accountant the following legal and financial documents regarding Partnership's investment in PFIC 1: 1) the operating agreement regarding Partnership, 2) the special amendment to Partnership's operating agreement, which identified Partnership's investment in Foreign Corp but made no reference to PFIC 1, and 3) Partnership's income statement, balance sheet and general ledger. Partnership's balance sheet, as provided by Bookkeeper to Accountant, also identified Partnership's investment in Foreign Corp without making any reference to PFIC 1. Partnership, either through its partners or Bookkeeper, failed to provide Accountant with any documents or information indicating that it owned the stock of PFIC 1. The legal and financial documents provided to Accountant regarding Partnership's investments referred only to Foreign Corp. Accountant prepared Taxpayer's federal income tax return for taxable year ended December 31, 1999, but did not include an election to treat any of Partnership's investments as QEFs pursuant to section 1295.

At the end of 2000, Partner 1 was appointed a director of PFIC 1 to assist PFIC 1 in selling its investment interest in Foreign Corp. PFIC 1 sold some of the shares it owned in Foreign Corp during December 2000. In early 2001, following the December 2000 sale of some of PFIC 1's shares in Foreign Corp, Partner 1 became aware that PFIC 1 might be a PFIC under section 1297(a). Partner 1 consulted with various tax professionals during 2001 to determine whether there was a potential PFIC issue with

respect to Partnership's investment in PFIC 1. On November 27, 2001, Partnership sold its remaining interest in PFIC 1. At the end of 2001, a tax professional engaged by Partner 1 confirmed that PFIC 1 had been a PFIC during Partnership's entire holding period of PFIC 1's stock. Partnership represents that it was advised by several tax professionals to treat its share of the capital gain from PFIC 1's sale of stock in Foreign Corp, and from its subsequent sale of stock in PFIC 1, as if Partnership's investment in PFIC 1 were an investment in a QEF. This position was disclosed on Partnership's 2001 federal income tax return that was prepared by Accounting Firm.

On May 23, 2003, we informed Partnership of our tentative adverse position regarding its request for the Commissioner's consent to make a retroactive QEF election with respect to PFIC 1 for Partnership's 1999 tax year. Partnership's conference-of-right was held on June 17, 2003. Following the conference-of-right, we received and reviewed additional information submitted on July 9, 2003.

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").

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. Section 1295(b)(2) states that an election may be made for any taxable year at any time (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"). Where, as here, a domestic partnership holds an interest in stock of a PFIC, the domestic partnership makes the retroactive election with respect to that PFIC. Treas. Reg. §§ 1.1295-3(g)(3), 1.1295-1(d)(2)(i)(A).

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 provides,

> 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—
>
> (A) Was not competent to render tax advice with respect to the ownership shares of a foreign corporation; or
>
> (B) Did not have access to all relevant facts and circumstances.

Treas. Reg. § 1.1295-3(f)(2) (emphasis added).

In the present case, Partnership is not considered to have reasonably relied on a qualified tax professional where its partners, including Partner 1 who served as a director of PFIC 1, knew or reasonably should have known that Accountant did not have access to all relevant facts and circumstances, specifically, that Partnership owned the stock of PFIC 1. All legal and financial documents provided to Accountant referred only to a direct investment in Foreign Corp and did not make any reference to PFIC 1. Because Partnership has not satisfied the first requirement for retroactive relief under Treas. Reg. § 1.1295-3(f), we do not reach the issue of whether the remaining requirements have been satisfied. Accordingly, Partnership's request to make a retroactive QEF election for Partnership's 1999 taxable year, with respect to the stock of PFIC 1 owned by Partnership, is denied.

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

Sincerely,

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

cc: