Internal Revenue Service

Department of the Treasury

Number: **200339053**
Release Date: 0926/2003
Index Number: 1295.02-02

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:INTL:Br2, PLR-113859-00 WLI1
Date:

In Re:

LEGEND:

Trust A =

Trust B =

Corp A =

Corp B =

Corp C =

Partnership A =

Partnership B =

Partnership C =

Partnership D =

Partnership E =

Partnership F =

Partnership G =

Individual A =

Individual B =

Individual C =

Individual D =

Individual E =

Individual F =

Individual G =

Individual H =

Individual I =

Individual J =

Individual K =

Individual L =

Individual M =

Individual N =

Individual O =

Individual P =

Individual Q =

Firm A =
FP =

GP =
FC1 =
FC2 =
FC3 =
FC4 =
FC5 =
FC6 =
FC7 =
FC8 =
FC9 =
FC10 =

FC11 =
Year 1 =
Year 2 =
Year 3 =

Dear :

This private letter ruling is in response to your request dated June 6, 2000, for a determination that Trusts A and B, Corps A through C, Partnerships A through F, and Individuals A through Q (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.

FP is a limited partnership organized in Year 1 under the laws of Bermuda. GP, a U.S. limited partnership is the general partner of FP. Trusts A and B, domestic trusts, Corps A and B, domestic corporations, and Partnerships A through F, domestic partnerships, became limited partners of FP in Year 1. Also in Year 1, FC11, a foreign corporation, and Partnership G, a foreign partnership, became limited partners of FP. Individuals A through F, U.S. individuals, and Corp C, a domestic corporation, owned stock in FC11. Individuals G, H and I, U.S. individuals, were partners in Partnership G. Individuals J through Q, U.S. individuals, became limited partners of FP in Year 2.

During Year 1, FP acquired the stock of FC1, a foreign corporation that is treated as a PFIC under section 1297(a).[1] Therefore, under section 1298(a)(2) and (3), Trusts A and B, Corps A through C, Partnerships A through F and Individuals A through I were indirect shareholders of FC1. For the taxable year ended December 31, Year 1, FP elected to treat FC1 as a QEF and filed a Form 8621 with FP's U.S. partnership income tax return. FP attached the PFIC annual information statement for FC1 to Form 8621 for such taxable year. No QEF elections were made by Trusts A and B, Corps A through C, Partnerships A through F or Individuals A through I with respect to FC1 for taxable year ended December 31, Year 1.

Trusts A and B, Corps A through C, Partnerships A through F, Individuals A through I and FP have represented that the items of income and gain reported on the Schedules

[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.

K-1 for the Year 1 taxable year included the ordinary earnings and net capital gain of FC1. 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 a PFIC.

During Year 2, FP acquired the stock of five foreign corporations (FC2, FC3, FC4, FC5 and FC6) that are treated as PFICs under section 1297(a). Therefore, Taxpayers were indirect shareholders of FC2, FC3, FC4, FC5 and FC6. Section 1298(a)(2) and (3). For taxable year ended December 31, Year 2, FP did not file a Form 8621 with its U.S. partnership income tax return for FC1 through FC6 and did not elect QEF status for FC2 through FC6. No QEF elections were made by Taxpayers with respect to FC2 through FC6 for taxable year ended December 31, Year 2.

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 2 taxable year included the ordinary earnings and net capital gain of FC1 through FC6. However, the items of income and gain reported on Schedules K-1 did not specifically identify that such amounts included ordinary earnings and net capital gain earned from PFICs.

During Year 3, FP acquired the stock of four foreign corporations (FC7, FC8, FC9 and FC10) that are treated as PFICs under section 1297(a). Therefore, Taxpayers were indirect shareholders of FC7, FC8, FC9 and FC10. Section 1298(a)(2) and (3). For taxable year ended December 31, Year 3, FP elected to treat FC7 through FC10 as QEFs and filed Forms 8621 with FP's U.S. partnership income tax return. Further, FP also elected to treat FC2 through FC6 as QEFs and filed Forms 8621 with its U.S. partnership income tax return for taxable year ended December 31, Year 3. FP attached the PFIC annual information statements, for FC1 through FC10, to Forms 8621 for that taxable year. No QEF elections were made by Taxpayers with respect to FC2 through FC10 for taxable year ended December 31, Year 3.

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 3 taxable year included the ordinary earnings and net capital gain of FC1 through FC10. However, the items of income and gain reported on Schedules K-1 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 the Year 1 through Year 3 taxable years. 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 income tax return (Form 1065) and the Schedules K-1 for FP's partners for those taxable years. Firm A had access to all relevant facts, including financial information, regarding FP's investments in FC1 through FC10.

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 FC10, it did not advise Taxpayers of the consequences of making, or failing to make, the section 1295 QEF election. Further, 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) sets forth the standard for reasonable reliance on a qualified tax professional. With certain exception, 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, 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 for the Year 1 taxable year and for FC2 through FC10 for the Year 3 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 FC10, and thus, the elections should have been made by Taxpayers. Although Taxpayers failed to make timely QEF elections for FC1 through FC10, they may request the consent of the Commissioner to make retroactive QEF elections, under Treas. Reg. § 1.1295-3(f), effective for the respective taxable years in which they indirectly acquired ownership in the stock of FC1 through FC10.

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 FC10, and knew that such entities were PFICs. Firm A did not inform Taxpayers that FC1 through FC10 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 FC10 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 FC10. 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 FC10 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, and provided Taxpayers comply with the rules under Treas. Reg. §1.1295-3(g) regarding time and manner for making the retroactive QEF election, consent is hereby granted under Treas. Reg. §1.1295-3(f) to make retroactive section 1295 QEF elections with respect to FC1 through FC10 as follows:

1. Trusts A and B, Corps A through C, Partnerships A through F and Individuals A through I are granted consent to make retroactive QEF elections with respect to FC1 for the Year 1 taxable year;

2. Individuals J through Q are granted consent to make retroactive QEF elections with respect to FC1 for taxable year ended December 31, Year 2;

3. Taxpayers are granted consent to make retroactive QEF elections with respect to FC2, FC3, FC4, FC5 and FC6 for taxable year ended December 31, Year 2; and

4. Taxpayers are granted consent to make retroactive QEF elections with respect to FC7, FC8, FC9 and FC10 for taxable year ended December 31, Year 3.

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 FC10 for taxable years ended after Year 3.

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)