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-137252-03
Date:
November 06, 2003

In Re:

DO: TY:

LEGEND

Taxpayer	=
FC1	=
FC2	=
Partnership 1	=
Partnership 2	=
State A	=
Accountant A	=
Accountant B	=
Accounting Firm 1	=
Accounting Firm 2	=
Country X	=
Country Y	=

Date 1 =
Date 2 =
Date 3 =

Dear :

This is in response to your letter dated June 17, 2003, requesting the consent of the Commissioner of the Internal Revenue Service ("IRS") for Taxpayer to make a retroactive qualified electing fund ("QEF") election under section 1295 of the Internal Revenue Code ("Code") and corresponding Treas. Reg. §1.1295-3(f).

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 this request for ruling, such material is subject to verification upon examination.

FACTS AND REPRESENTATIONS:

FC1, a Country Y limited company that was incorporated on Date 1, 1995, was established to invest in North Sea oil and gas activities. It is treated as a corporation for U.S. federal income tax purposes. Taxpayer was the sole shareholder of FC1 until Date 2, 1997.

Partnership 1, a Country X partnership, was formed to manage the overall activity of FC1 pursuant to a management agreement dated Date 3, 1996. It is treated as a partnership for U.S. federal income tax purposes.

FC2, a Country X limited company, was formed to hold the capital and profits interests in Partnership 1. FC2 held a 25% capital and profits interest in Partnership 1 for 1996 and 1997. This interest was reduced to 20% during 1998. FC2 is treated as a corporation for U.S. federal income tax purposes. Taxpayer held 100% of FC2's issued shares (consisting of 2 ordinary shares) until Date 2, 1997.

Partnership 2, formed as a U.S. limited liability company under State A law, held the other 75% of the capital and profits interest of Partnership 1 for 1996 and 1997. This interest was increased to 80% during 1998. Partnership 2 is treated as a partnership for U.S. federal income tax purposes. Taxpayer holds a 40% member interest in Partnership 2. The remaining members are U.S. persons.

On Date 2, 1997, Taxpayer transferred his 100% interest in FC1 to FC2 in exchange for additional ordinary shares of FC2. In addition, FC2 also issued additional ordinary shares to other shareholders, all of whom were U.K. persons. Also on Date 2, FC1 issued additional ordinary shares to FC2, giving FC2 100% of the ordinary shares of FC1.

During 1997, Partnership 1 obtained a 1% interest in the preferred shares of FC1.

The Date 2, 1997 transfer by Taxpayer of FC1 stock to FC2 constituted a taxable event to Taxpayer in 1997. However, because of the nominal value of the shares, Taxpayer did not recognize any gain on the transfer.

FC1 was a passive foreign investment company ("PFIC"), within the meaning of section 1297(a), from the date of its formation through 1997. In 1995, FC1 had no income. In 1996 and 1997, FC1 had losses. From 1998 to the present, FC1 has been a former PFIC, within the meaning of Treas. Reg. §1.1291-9(j)(2)(iv), as it has generated significant amounts of non-passive revenue and non-passive assets related to managing and operating oil and gas interests in the North Sea.

Since the early 1980's, Accountant A, a senior tax consultant with Accounting Firm 1 in Country X, has advised Taxpayer on his U.S. individual income tax matters and prepared his U.S. federal income tax returns. Neither Accountant A nor Accounting Firm 1 identified Taxpayer's direct ownership interest in FC1 from 1995 to 1997 as a direct ownership in a PFIC or advised Taxpayer regarding the availability of a QEF election.

In August 2002, while in the process of preparing Taxpayer's 2001 U.S. federal income tax return, Taxpayer approached Accountant A regarding the possible U.S. tax consequences of disposing of his indirect interest in FC1 through either a disposal of his interest in Partnership 2 or Partnership 2 disposing of its interest in a subsidiary entity. Accountant A referred Taxpayer's question to Accountant B, a senior tax manager with Accounting Firm 2 in an office in Country Y. Accountant B reviewed various issues involving Taxpayer's ownership interest in FC1. In February 2003, Accountant B, in working with a U.S. office of Accounting Firm 2, determined that Taxpayer's direct ownership interest in FC1 from 1995 through 1997 was an ownership interest in a PFIC and that Taxpayer could have made a QEF election on his 1995 U.S. federal income tax return with respect to FC1. Accordingly, Taxpayer was advised to seek relief under the special consent procedures of Treas. Reg. §1.1291-3(f)

Taxpayer has submitted affidavits executed by Accountant A and Accountant B which reflect the above statements concerning Accountant A and Accounting Firm 1's failure to advise Taxpayer of the possibility of making, or the consequences of failing to make, a QEF election and the events leading to the discovery thereof.

Taxpayer represents that the PFIC status of FC1 has not been raised by the IRS on audit for any taxable year of Taxpayer.

RULING REQUESTED:

Taxpayer requests the consent of the Commissioner to make a retroactive QEF election under Treas. Reg. §1.1295-3(f) with respect to FC1 for the tax year 1995.

LAW AND ANALYSIS:

Section 1295(a) provides that any PFIC shall be treated as a QEF with respect to a taxpayer if (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 the Secretary may prescribe for purposes of determining the ordinary earnings and net capital gain of such company. Under section 1295(b)(2), a QEF 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 for such taxable year ("election due date"). To the extent provided in regulations, such an election may be made later than the election due date if the taxpayer failed to make a timely election because the taxpayer reasonably believed the company was not a PFIC.

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 the consent will not prejudice the interests of the United States government;
3) the shareholder requests consent before a representative of the IRS raises upon audit the PFIC status of the corporation for any taxable year of the shareholder; and
4) the shareholder satisfies all procedural requirements.

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 such a 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. The section further provides 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 advise with respect to the ownership of shares of a foreign corporation or did not have access to all relevant facts and circumstances.

In the present case, Taxpayer relied upon Accountant A and Accounting Firm 1 for advice on his U.S. individual income tax matters. Taxpayer also relied on Accountant A and Accounting Firm 1 to advise him on all issues relating to the preparation of his U.S. federal income tax return, including the consequence of making or failing to make available elections, such as a QEF election. Taxpayer was not a tax professional and was unaware that FC1 in which he invested was a PFIC until Accountant B made that determination in February 2003. Accountant A and Accounting Firm 1 were competent to render tax advice with respect to stock ownership in a foreign corporation and had access to all the relevant facts and circumstances, but did not identify FC1 as a PFIC, nor did they inform Taxpayer of the availability of a section 1295 election. Thus, Taxpayer reasonably relied on a qualified tax professional within the meaning of Treas. Reg. §1.1295-3(f)(1)(i) and (2) for the tax years at issue.

The second requirement, under Treas. Reg. §1.1295-3(f)(1), is that granting consent will not prejudice the interests of the U.S. government. Under Treas. Reg. Reg. §1.1295-3(f)(1)(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. In the present case, because FC1 had no income for the years at issue and Taxpayer would have had no income inclusion under section 1293 of the Code had he made a timely QEF election for those years, the interests of the U.S. government will not be prejudiced by allowing Taxpayer to make a retroactive section 1295 election.

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 IRS raises upon audit the PFIC status of the corporation for any taxable year of the shareholder. Taxpayer has represented that he requested consent to make a retroactive QEF election for tax year 1995 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 a retroactive election and remitting the appropriate user fee to 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 section 1295 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. Here, affidavits meeting the requirements set forth in Treas. Reg. §1.1295-3(f)(4)(ii) and (iii) have been submitted. Further, Taxpayer has submitted the appropriate user fee. Therefore, Taxpayer has met the procedural requirements of Treas. Reg. §1.1295-3(f)(4).

Based on the information submitted and the representations made, Taxpayer is permitted to make a retroactive QEF election under Treas. Reg. §1.1295-3(f) with respect to FC1 effective for his taxable year 1995 provided Taxpayer complies with the rules under Treas. Reg. §1.1295-3(g) regarding time and manner for making the retroactive QEF election.

We express no opinion about whether the retroactive QEF election would apply to the interest in FC1 indirectly owned by Taxpayer through Partnership 2.

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 letter is being sent to Taxpayer.

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

Sincerely,

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

CC: