Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:INTL:BR3-PLR-103746-00
Date:
August 5, 2002

TY:

Legend:

Taxpayers =

Company =
Year A =
Year B =
Firm =
X =
Y =

Dear . :

This is in reply to the February 1, 2000 letter submitted by your representative, which requested a ruling that Taxpayers be allowed to make a retroactive election under Treas. Reg. §1.1295-3(f) with respect to Company, a foreign corporation, for Taxpayers' 1987 taxable year. Additional information was submitted on May 11, 2000, September 22, 2000, February 15, 2001 and November 2, 2001.

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. 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.

Taxpayers are calendar year, cash basis taxpayers. Taxpayers purchased X shares of Company in Year A and continued to purchase additional shares in subsequent years. Throughout their 1987 taxable year, Taxpayers held Y shares of Company. Company has been a PFIC, within the meaning of section 1297(a), since Taxpayers' 1987 taxable year, the first taxable year for which the PFIC rules were effective. Taxpayers were not

tax professionals and had no knowledge of the existence of the PFIC regime.

Firm, a qualified tax professional, within the meaning of Treas. Reg. §1.1295-3(f)(2), has served as accountant to Taxpayers. Firm has prepared Taxpayers federal income tax returns for all years during which Taxpayers have owned stock in Company. Taxpayers have relied upon Firm to advise them as to all aspects of their federal income taxes, including the consequences of making, and failing to make, all available elections on their federal income tax returns. Firm failed to identify Company as a PFIC, and failed to advise Taxpayers of the consequences of making, or failing to make, the section 1295 election.

In Year B, while performing consulting work related to one of the holdings of Company, Firm determined that Company was a PFIC. Firm further determined that a QEF election had not been made with respect to Taxpayers' ownership interest in Company. Taxpayers then requested the Commissioner's consent to retroactively elect QEF treatment with respect to the stock they owned in Company.

A PFIC will be treated as a qualified electing fund (QEF) with respect to a taxpayer if the taxpayer makes a valid QEF election under section 1295. A taxpayer that elects QEF treatment includes in gross income his pro rata share of the ordinary earnings and net capital gain of the QEF for the taxable year. A QEF election applies to the taxable year for which it is made and all subsequent taxable years unless revoked by the taxpayer with the consent of the Secretary. Section 1295(b)(1). A QEF election may be made for a taxable year on or before the due date (determined with regard to extensions) for filing the return for such taxable year. To the extent provided in regulations, a QEF election may be made after such due date if the taxpayer failed to make an election by the due date because the taxpayer reasonably believed the company was not a PFIC. Section 1295(b)(2).

Treas. Reg. §1.1295-3 provides rules for making a retroactive QEF election. Under these regulations, a shareholder of a PFIC that meets certain conditions may make a retroactive election without obtaining the consent of the Commissioner. Treas. Reg. §1.1295-3(b) or (e). Taxpayers have not met these conditions. A shareholder may also make a retroactive QEF election with the Commissioner's consent if it meets the requirements of Treas. Reg. §1.1295-3(f).

The Commissioner will grant relief under Treas. Reg. §1.1295-3(f) only if four requirements are satisfied. Treas. Reg. §1.1295-3(f)(1)(i)-(iv). The first requirement is that 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 section 1295 election. Treas. Reg. §1.1295-3(f)(2) provides that a shareholder will not be considered to have reasonably relied upon a qualified tax professional if the shareholder knew, or reasonably should have known, that the foreign corporation was a PFIC and knew of the availability of a

section 1295 election. In addition, a shareholder cannot claim reliance upon a tax professional that the taxpayer knew, or reasonably should have known, was not competent to render tax advice with respect to stock ownership of a foreign corporation or did not have access to all relevant facts and circumstances.

Taxpayers relied upon Firm for all aspects of their federal income tax return preparation, including the consequences of making or failing to make all available elections. Taxpayers were not tax professionals, and were entirely unaware of the existence of the PFIC regime until it was brought to their attention in Year B. Firm was competent to render tax advice with respect to stock ownership of a foreign corporation, but did not identify Company as a PFIC or inform Taxpayers of the availability of a section 1295 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) is that granting consent will not prejudice the interests of the United States government. Under Treas. Reg. §1.1295-3(f)(3)(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.

Notwithstanding the general rule of Treas. Reg. §1.1295-3(f)(3)(i), if granting relief would prejudice the interests of the United States government, the Commissioner may, in the Commissioner's sole discretion, grant consent to make the 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 United States government as a consequence of the shareholder's inability to file amended returns for closed taxable years. Treas. Reg. §1.1295-3(f)(3)(ii).

Taxpayers have entered into a closing agreement with the Commissioner and paid an amount sufficient to eliminate any prejudice that would have resulted from Taxpayers' inability to file amended returns for closed taxable years. Therefore, the interests of the U.S. government will not be prejudiced by allowing Taxpayers to make a retroactive section 1295 election.

The third requirement for making a special consent election under Treas. Reg. §1.1295-3(f) 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. Treas. Reg. §1.1295-3(f)(1)(iii). Taxpayers have requested consent under these special consent provisions before the issue has been raised on audit.

The final requirement for making a special consent election is that the procedural requirements set forth in Treas. Reg. §1.1295-3(f)(4) must be met. Affidavits meeting these requirements and describing Firm's failure to inform Taxpayers of their need to make a QEF election have been submitted, and Taxpayers have otherwise met the procedural requirements of Treas. Reg. §1.1295-3(f)(4).

Based on the information submitted and representations made, consent is granted to allow Taxpayers to make a retroactive election under Treas. Reg. §1.1295-3(f) with respect to Company for their 1987 taxable year, provided Taxpayers comply with the rules under Treas. Reg. §1.1295-3(g) regarding the time and manner for making the retroactive QEF election.

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

Sincerely,

Valerie Mark Lippe
Senior Technical Reviewer
CC:INTL:BR2