Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

[Third Party Communication:
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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:INTL:B02
PLR-157420-03
Date: January 12, 2005

TY:

Legend

Taxpayer =

Individual A =
Individual B =

FC1 =
FC2 =

Country X =

Location A =

Date 1 =
Date 2 =
Accountant A =

Date 1 =
Date 2 =

X percent =

Amount A =
Amount B =
Amount C =
Amount D =
Amount E =

Dear

This is in response to your letter dated September 15, 2003, submitted by your authorized representative, requesting the consent of the Commissioner of the Internal Revenue Service ("IRS") for you 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:

For many years, Taxpayer has owned all of the common stock and approximately X percent of the preferred stock in FC1, a Country X corporation. FC1 is a holding company that owns approximately X percent of the stock in FC2, also a Country X corporation. Virtually all of FC1's assets consist of stock in FC2 which represent at least 25% of the value of the outstanding FC2 stock. FC1 is managed by Individual A, Taxpayer's mother, who is a Country X citizen and resident.

FC2 is in the business of owing a single valuable parcel of real property with a commercial building on it in Location A. More than 90% of FC2's gross income consists of rents and more than 60% of the total value of FC2's assets consists of rental real estate. Individual A and Individual B, Taxpayer's aunt, managed FC2 until Date 1, the day of Individual B's death. Thereafter, Individual A was the sole manager of FC2.

Taxpayer has not been involved in the establishment, management, or operations of either FC1 or FC2.

The commercial building owned by FC2 was actively maintained by a staff of FC2 employees who cleaned the hallways, removed the trash, maintained the heat and hot water, and performed other day-to-day maintenance. However, on Date 2, FC2 entered into a lease for the entire property with a single tenant. Under the terms of the lease, the lessee is responsible for most operational functions, although FC2 retains certain management functions.

Initially, FC2 had an active leasing business but that business changed in when FC2 leased all of its real property to a single tenant who performed some of the

activities that FC2 had previously performed. As a result, FC2 became a passive foreign investment company ("PFIC"), within the meaning of section 1297(a) on Date 2.

Accountant A has advised Taxpayer on his U.S. individual income tax matters and prepared his U.S. federal income tax returns for more than ten years. Accountant A knew of Taxpayer's ownership in FC1 and FC1's ownership in FC2, but did not identify Taxpayer's ownership interest in FC1 as ownership in a PFIC or advise Taxpayer regarding the availability of a QEF election.

It was not until the settlement of Individual B's estate that Taxpayer first became aware of his PFIC ownership interests. In connection with the settlement of the estate, a Country X tax attorney familiar with U.S. tax laws became aware of the PFIC status of FC1 and FC2. The Country X tax attorney, after consulting with a U.S. tax attorney, advised Taxpayer that FC2 may have become a PFIC after Date 2, when FC2 entered into the lease agreement. The Country X attorney also advised Taxpayer that he may be able to make a retroactive QEF election under section 1295.

Taxpayer has submitted affidavits executed by Accountant A which reflect the above statements concerning Accountant A'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 and FC2 has not been raised by the IRS on audit for any taxable year of Taxpayer.

If Taxpayer had made a timely QEF election for FC1 and FC2 effective for his tax year, he would have included in gross income, under section 1293, Amount A for his tax year, Amount B for his tax year, and amount C for his tax year.

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 and FC2 for the tax year 2001.

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 for advice on his U.S. individual income tax matters. Taxpayer also relied on Accountant A 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 and FC2 were PFICs until a Country X attorney made that determination sometime after December 12, 2001, in connection with the settlement of Individual B's estate. Accountant A was 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 or FC2 as a PFIC, nor did he 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).

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. §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. If granting relief would prejudice the interests of the U.S. government, the Commissioner may, in his 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 U.S. 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).

In the present case, Taxpayer has agreed to any tax deficiencies resulting from the income inclusion under section 1293 of the Code computed as if he made a timely QEF election effective as of the taxable year. Neither the taxable year nor subsequent tax years currently are closed. Thus, provided Taxpayer files amended returns for his 2001 and subsequent tax years in connection with this retroactive QEF election before such tax years are closed, 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 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).

It has been determined that if Taxpayer had made a timely QEF election for FC1 and FC2, effective for his tax year, he would have included in gross income under section 1295 Amount A for his tax year, Amount B for his tax year, and Amount C for his 2003 tax year. It has also been determined that, if Taxpayer makes

the QEF election retroactively, the tax deficiency resulting from this additional income will be Amount D for his tax year and Amount E for his tax year. The tax deficiency for his and subsequent tax years has not yet been determined.

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 and FC2 effective for his taxable year , based on the above figures, plus interest, provided Taxpayer complies with the rules under Treas. Reg. §1.1295-3(g) regarding the manner for making the retroactive QEF election and provided Taxpayer makes the retroactive election before the period for assessment of tax under section 6501 has expired with respect to Taxpayer's and subsequent tax returns.

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.

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

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,

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

cc: