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TY

Legend

Husband =

Wife =

X =

FC =

Individual 1 =
Individual 2 =

Accountant 1 =
Accountant 2 =
Accountant 3 =

Accounting Firm Y =
Accounting Firm Z =

Year 1 =

Year 2 =
Year 3 =
Year 4 =

Date 1 =
Date 2 =
Date 3 =

A =
B =
C =

Dear :

This is in response to a letter received by our office on January 4, 2008, submitted on behalf of Taxpayers by their authorized representative, requesting the consent of the IRS Commissioner to make a retroactive qualified electing fund ("QEF") election under section 1295 of the Internal Revenue Code ("Code") and Treas. Reg. §1.1295-3(f) with respect to Taxpayers' investment in FC.

The ruling contained in this letter is based upon information and representations submitted by Taxpayers and accompanied by a penalty of perjury statement executed by appropriate parties. While this office has not verified any of the material submitted in support of the request for a ruling, it is subject to verification on examination.

FACTS

Taxpayers, Husband and Wife, are U.S. citizens residing and working outside the United States. In Year 1, as a personal investment, Husband purchased A shares of FC, a company formed in Country X. No shareholder of FC was or is related to Taxpayers within the meaning of section 954(d)(3) of the Code.

During Year 1, FC acquired a foreign-owned company with two lines of business: an oil exploration and production business, and a chemical business. On Date 1, FC sold the assets used in the oil exploration and production business for approximately B dollars (the "Sale"). As part of a series of agreements between FC and the purchaser relating to the Sale, FC was obligated, until a then-undetermined date in Year 3, to (i) use a portion of the Sale proceeds to purchase and retain stock in the purchasing entity and (ii) place in escrow a portion of the Sale proceeds for investment in liquid assets. The remainder of the Sale proceeds were to be either reinvested in existing operations or distributed to its shareholders. Notwithstanding this intention, the remainder of the Sale proceeds in fact was invested in liquid assets for the remainder of Year 2 and much of Year 3. As a result of the terms of the Sale and FC's retention of the Sale proceeds, Husband's shares in FC became an investment in a PFIC as define under section 1297 of the Code.

On Date 2, Husband gifted to Wife C shares of FC. On Date 3, Taxpayers sold all of their shares of FC back to FC as part of a broad redemption. Since the date of redemption, Taxpayers have not owned any interest in FC.

During the years in which Taxpayers invested in FC, Individual 1 and Individual 2 served on the board of directors of FC. Individual 1 also served as the chief financial officer of FC and therefore, oversaw the company's financial and tax matters. FC engaged Accountant 1 and Accountant 2 with Accounting Firm Y to advise it with its operations and tax matters.

During Year 2 and Year 3, Husband attended several meetings in his capacity as a FC shareholder. Representatives of Accounting Firm Y also attended some of those meetings. Various subjects were discussed, among them the decision to undertake the Sale, the subsequent investment of the Sale proceeds, and the U.S. federal income tax considerations with respect to FC's operations and the Sale. During one particular meeting in Year 2 following the Sale, Accountant 1 discussed the U.S. federal tax consequences of the Sale and a plan whereby FC would redeem a significant portion of its shares (the "Redemption"). Accountant 1 explained that FC was a controlled foreign corporation under section 957(a) of the Code. Further, Husband represents that Accountant 1 informed him that he need not be concerned with the PFIC rules despite the fact that he held less than 10 percent of the shares of FC.

Taxpayers have not had formal training with respect to U.S. federal income tax law. Therefore, they have consistently relied on the advice of tax professionals to comply with their U.S. federal income tax obligations. Taxpayers' primary personal tax advisor during Year 2 was Accountant 3 with Accounting Firm Z. Accountant 3 had worked on Taxpayers' U.S. federal income tax returns prior to Year 2 but not as the principal preparer. To assist Accountant 3 in preparing their Year 2 U.S. federal income tax return, Husband reminded Accountant 3 of Taxpayers' investment in FC, informed Accountant 3 of the Sale, and described Taxpayers' potential participation in the Redemption. Husband also communicated the advice of Accountant 1 with Accounting Firm Y to Accountant 3.

It was not until Year 4, when Accountant 3 was calculating Taxpayers' extended-filing payment for the Year 3 U.S. federal income tax return and Taxpayers' Year 4 estimated U.S. federal income tax liability, that it was discovered that FC was a PFIC with respect to Taxpayers. When Individual 1 was contacted to confirm the advice Husband believed he had received from Accountant 1 in Year 2, Individual 1, who oversaw FC's financial and tax matters, explained that the PFIC rules likely applied to the shares of FC held by Taxpayers.

Accountant 3 is a competent and reputable tax professional who had full access to all relevant information regarding Taxpayers' investment in FC. However, Accountant 3 failed to identify FC as a PFIC and failed to advise Taxpayers of the possibility of making, or the consequences of failing to make, a QEF election with respect to FC.

Taxpayers have submitted an affidavit, under penalties of perjury, describing the events that led to the failure to make the QEF election by the election due date, including the role of Accountant 3. Taxpayers represent that Accountant 3 prepared and filed their U.S. federal income tax returns, and rendered tax advice on various U.S. and international tax issues. Taxpayers represent that they relied Accountant 3 for tax advice. Taxpayers have also submitted an affidavit of Accountant 3 corroborating the representations made by Taxpayers.

Taxpayers represent that the PFIC status of FC has not been raised by the IRS on audit for any of the taxable years.

RULING REQUESTED

Taxpayers request the consent of the IRS Commissioner to make a retroactive election under Treas. Reg. §1.1295-3(f) with respect to FC for Taxpayers' Year 2.

LAW AND ANALYSIS

Section 1293(a) of the Code provides that every U.S person who owns stock of a QEF at any time during the taxable year of such fund shall include in gross income 1) as ordinary income, such shareholder's pro rata share of the ordinary earnings of such fund for such taxable year, and 2) as long-term capital gain, such shareholder's pro rata share of the net capital gain of such fund for such taxable year.

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 such requirements as the Secretary may prescribe for purposes of determining the ordinary earnings and net capital gains 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. To the extent provided in regulations, such an 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.

Under Treas. Reg. §1.1295-3(f), a taxpayer may request the consent of the Commissioner to make a retroactive QEF election for a taxable year if:

1. the shareholder reasonably relied on a qualified tax professional, within the meaning of Treas. Reg. §1.1295-3(f)(2);
2. granting consent will not prejudice the interests of the United States government, as provided in Treas. Reg. §1.1295-3(f)(3);
3. the request is 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; and
4. the shareholder satisfies the procedural requirements of §1.1295-3(f)(4).

The first requirement is that the shareholder reasonably relied on a qualified tax professional, within the meaning of Treas. Reg. §1.1295-3(f)(2). 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 knew of the availability of a section 1295 election. Treas. Reg. §1.1295-3(f)(2)(i). In addition, a shareholder cannot claim reliance upon a qualified tax professional if he know or reasonably should have known that the tax professional relied upon was not competent to render tax advice with respect to the ownership of shares of a foreign corporation or did not have access to all the relevant facts and circumstances. Treas. Reg. §§1.1295-3(f)(2)(i)(A) and (B)

According to the facts submitted and the representations made, Taxpayers relied on the advice of Accountant 3, their tax advisor for the years at issue, to prepare and file Taxpayers' U.S. federal income tax returns and to provide advice on U.S. and international tax issues. Accountant 3 failed to identify FC as a PFIC and failed to advise Taxpayers of the consequences of making, or failing to make, QEF elections. Accountant 3 was a C.P.A. competent to render tax advice with respect to ownership of shares of a foreign corporation and who had access to all relevant facts and circumstances. Additionally, Taxpayers did not know, and should not reasonably be expected to have known, that FC was a PFIC, or of the availability of a QEF election. Thus, Taxpayers have satisfied the first requirement of Treas. Reg. §1.1295-3(f)(1) because Taxpayers reasonably relied on a qualified tax professional within the meaning of Treas. Reg. §1.1295-3(f)(2).

The second requirement is granting consent in this case will not prejudice the interests of the United States government as provided in Treas. Reg. §1.1295-3(f)(3). Pursuant to Treas. Reg. §1.1295-3(f)(3)(i), 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. According to the facts submitted and the representations made, the interests of the United States government are not prejudiced because the granting of relief does not result in Taxpayers having a lower tax liability than Taxpayers would have had if Taxpayers had made the QEF election by the election due date. Further, neither Year 2 nor any subsequent taxable year is closed for Taxpayers. Thus, Taxpayers have satisfied the second requirement of Treas. Reg. §1.1295-3(f)(1) because granting consent in this case will not prejudice the interests of the United States government.

The third requirement 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. Taxpayers have satisfied the third requirement of Treas. Reg. §1.1295-3(f)(1) because they have represented that the request to make a retroactive QEF election was made before a representative of the IRS raised the PFIC status of FC in on audit.

The final requirement 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 include filing a request for consent to make a retroactive election with, and submitting a 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 that describe:

1. the events which led to the failure to make a QEF election by the election due date;
2. the discovery of such failure;
3. the engagement and responsibilities of the qualified tax professional; and
4. the extent to which the shareholder relied on such professional,

Treas. Reg. §§1.1295-3(f)(4)(ii) and (iii).

According to the facts submitted and the representations made, Taxpayers have filed a completed ruling request, including the correct user fee, and submitted complete and appropriate affidavits. Thus, Taxpayers have satisfied the fourth requirement of Treas. Reg. §1.1295-3(f)(1).

Based on the information submitted and representations made:

Consent is granted to Taxpayers to make a retroactive QEF election with respect to FC for Year 2 under Treas. Reg. §1.1295-3(f), provided that Taxpayers comply with the rules under Treas. Reg. §1.1295-3(g) regarding the time and manner for making the retroactive QEF elections.

This private letter ruling is directed only to the taxpayer who requested 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 letter is being sent to Taxpayers' first representative.

Sincerely,

Ethan A. Atticks
Senior Technical Reviewer, Branch 2
(International)