Internal Revenue Service

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Department of the Treasury
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Person To Contact:
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Telephone Number:

Refer Reply To:
CC:INTL:B02
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August 16, 2012

TY:

Legend

Applicant =

FC =

Date 1 =

Date 2 =

Date 3 =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

Year 6 =

Year 7 =

Year 8 =

x% =

y% =

z% =

M =

Firm P =

Firm Q =

Firm R =

Firm S =

Dear :

This is in response to a letter dated April 29, 2011, submitted by Applicant's authorized representative, that requested the consent of the Commissioner of the Internal Revenue Service ("Commissioner") for Applicant to make a retroactive qualified electing fund ("QEF") election under section 1295(b) of the Internal Revenue Code ("Code") and Treas. Reg. §1.1295-3(f) with respect to Applicant's investment in FC.

The ruling contained in this letter is based upon information and representations submitted on behalf of Applicant by its authorized representatives, and accompanied by a penalties 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 on examination. The information submitted in the request is substantially as set forth below.

FACTS

Applicant is a U.S. limited partnership. On Date 1 of Year 1 and Date 2 of Year 2, Applicant invested in FC via an offering of private placement shares. Applicant initially obtained approximately x% of FC in the Date 1 offering. After the Date 2 offering, Applicant's ownership percentage in FC was substantially reduced to about y%.

The investments in FC were made in part through wholly owned U.S. LLCs held by Applicant, which are treated as disregarded entities for U.S. federal income tax purposes. In addition, there have been subsequent offerings by FC in which Applicant has not participated and, as a result of the dilution of its initial investment, Applicant's collective ownership interest in FC was further reduced to approximately z% as of year-

end Year 6, which was the last year during which FC satisfied the asset or income test for PFIC status under section 1297 of the Code.

Since Date 3 of Year 3, Applicant has held FC as a “side pocket” investment. Side pocket investments are investments that Applicant intends to acquire and hold for an extended period of time. Applicant tracks the partners’ share of gains and losses on these investments separately from other investments in their portfolios that may be more liquid. The partners in Applicant are deemed to own a fixed percentage of each side pocket investment based on such partner’s ownership interest in Applicant at the time that the side pocket is created. The partners’ interests remain unchanged until the side pocket is closed, regardless of the partner’s ownership interest in the partnership. A new and distinct side pocket is created if there are subsequent investments in a security that is already subject to an existing side pocket arrangement. Partners investing in a partnership subsequent to the establishment of the side pocket arrangement are not invited to participate in the existing side pocket arrangement. The side pocket is closed when the securities in it are sold. The gain or loss on the investments is allocated to the side pocket partners based on the underlying ownership percentages.

Pursuant to Applicant’s partnership agreement, items of income, deduction, gain, and loss are allocated to each partner participating in the side pocket arrangement based on such partner’s respective interest in the side pocket investment for section 704(b), GAAP, and tax purposes. Such items are not allocated to any partner of Applicant that does not participate in the side pocket arrangement (e.g., partners that invested in Applicant after Date 3 of Year 3). Applicant’s financial statements include a definition of side pocket investments. FC has not made distributions to its shareholders since Applicant acquired FC in Year 1.

FC is a foreign corporation that actively develops and uses specialized technology to recover drillable oil from oil sands. FC employs approximately M people who are engaged in this activity or perform management and administrative functions associated with it. According to publicly available information, including FC’s securities filings, FC generally does not engage in investment activities, with the exception of short-term investment of working capital pending its deployment. However, substantial amounts of working capital are required in the early years of the type of business engaged in by FC. FC apparently met the asset test for PFIC classification under section 1297(a)(2) in its Year 1 tax year, and thus qualified as a PFIC. FC continued to qualify as a PFIC through its Year 6 tax year.

For Year 1 through Year 6 tax years, Applicant’s management company engaged four advisors for tax return preparation services for Applicant: Firm P for Year 1, Firm Q for Years 2 and 3, Firm R for Year 4, and Firm S for Years 5 through 8. These firms employ experienced tax professionals and were engaged to prepare Applicant’s partnership income tax returns. The firms advised Applicant with regard to U.S. federal income tax matters regarding Applicant’s operations and investments, including Applicant’s ownership of FC. Applicant relied on the firms to provide advice with

respect to filing and reporting requirements in general, as well as any elections or statements that would be necessary to elect specific tax treatment.

The offering materials received by Applicant's management company with respect to the initial investment in FC did not indicate that FC was a PFIC. Applicant and its management company considered FC to be engaged in an active business and had no reason to believe that FC qualified as a PFIC.

In June of Year 8, Applicant learned that there would be an Initial Public Offering of FC's stock and Applicant analyzed FC for tax purposes as part of the tax due diligence for the sale of a foreign security. At that time, Applicant's management company tested the PFIC status of FC as part of the tax review of the investment pending its ultimate disposition and concluded that FC may have been a PFIC beginning in Year 1, due to the fact that greater than 50 percent of FC's assets in Year 1 consisted of cash, a passive asset. Based on the initial analysis, Applicant's management company engaged Firm S on Applicant's behalf to evaluate FC's PFIC status and to advise on the U.S. federal income tax consequences of FC's potential PFIC status. Upon reviewing the financial statements of FC, Firm S determined that FC might qualify as a PFIC under section 1297 for Year 1 through Year 6. Based on Firm S's determination regarding the potential PFIC status of FC, Applicant requested Firm S to begin the process of preparing a private letter ruling request.

Applicant has submitted an affidavit, under penalties of perjury, describing the events that led to the failure to make the QEF elections by the election due dates, including the roles of its management company and Firms P, Q, R, and S. Applicant represents that it provided information regarding the ownership and financial data of FC to the firms and to its management company. Applicant represents that, in the relevant years: (1) FC was not identified as a PFIC; and (2) Applicant did not receive any advice regarding the availability of a QEF election with respect to FC.

Applicant has entered into a closing agreement with the Commissioner that requires Applicant to pay an amount sufficient to eliminate any prejudice to the United States government as a consequence of the inability to file an amended return. Further, Applicant has agreed to file an amended return for each of its subsequent taxable years affected by the retroactive election, if any.

Applicant represents that, as of the date of this request for ruling, the PFIC status of FC has not been raised by the IRS on audit for any of the taxable years at issue.

RULING REQUESTED

Applicant requests the consent of the Commissioner to make a retroactive QEF election with respect to FC under Treas. Reg. §1.1295-3(f), retroactive to Year 1, and effective for all subsequent years.

LAW

Section 1295(a) of the Code provides that a PFIC will be treated as a QEF with respect to a taxpayer if (1) an election by the taxpayer under section 1295(b) applies to such PFIC for the taxable year and (2) the PFIC 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 shareholder 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 Treas. Reg. §1.1295-3(f)(4).

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 that 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).

Under Treas. Reg. §1.1293-1(c)(1), shareholders owning stock of a QEF by reason of an interest in a partnership take into account the section 1293 inclusions with respect to the QEF shares owned by the partnership under the rules applicable to inclusions of income from the partnership.

CONCLUSION

Based on the information submitted and representations made with Applicant's ruling request, we conclude that Applicant has satisfied Treas. Reg. §1.1295-3(f). Accordingly, consent is granted to Applicant to make a retroactive QEF election with respect to FC for Year 1, provided that Applicant complies with the rules under Treas. Reg. §1.1295-3(g) regarding the time and manner for making the retroactive QEF election.

We will, accordingly, approve a closing agreement with the Applicant with respect to those issues affecting its tax liability on the basis set forth above. The necessary closing agreement for Taxpayer has been prepared in triplicate and is enclosed. In pursuance of our practice with respect to such agreements, the agreement contains a stipulation to the effect that any change or modification of applicable statutes enacted subsequent to the date of this agreement and made applicable to the taxable period involved will render the agreement ineffective to the extent that it is dependent upon such statutes.

Except as specifically set forth above, no opinion is expressed or implied concerning the U.S. federal tax consequences of the facts described above under any other provision of the Code.

This private letter ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter ruling must be attached to any federal income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

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,

Jeffery G. Mitchell
Branch Chief
(International)

cc: