

Date 12 =

Date 13 =

Date 14 =

Date 15 =

Tax Year End =

Dear _____ :

This is in response to a letter received by our office dated August 24, 2017 submitted by Shareholder requesting consent to revoke mark-to-market elections under section 1296 pursuant to Treas. Reg. § 1.1296-1(h)(3) with respect to its investments in FC1, FC2, and FC3.

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 the request for rulings, it is subject to verification on examination.

FACTS

Shareholder is a trust organized under the laws of State that is treated as a domestic corporation for U.S. federal income tax purposes. Shareholder is registered as a management company under the Investment Company Act of 1940, as amended, and is taxed as a regulated investment company (RIC) under subchapter M of the Internal Revenue Code.

Shareholder is a RIC that invests mainly in the stocks of companies that participate in Activity A, including companies that are passive foreign investment companies (PFICs) within the meaning of section 1297.

As a general practice, when a PFIC provides a PFIC Annual Information Statement (Statement) described in Treas. Reg. § 1.1295-1(g)(1), Shareholder seeks to elect to treat its PFICs as qualified electing funds (QEFs) within the meaning of section 1295 in the year of acquisition. For PFICs that did not provide Statements to their shareholders for the taxable year of the PFIC that ended during Shareholder's taxable year of acquisition, Shareholder has a general practice of making a mark-to-market (MTM) election under section 1296 with respect to the PFIC stock that is eligible for the MTM election.

Shareholder acquired an interest in each of the FCs on the following dates: (i) FC1: Date 1; (ii) FC2: Date 2; FC3: Date 3.¹ Each FC is a foreign corporation that was a PFIC in the year Shareholder first acquired an interest in the FC and in each relevant subsequent year. In addition, at all relevant times, Shareholder, which is a RIC, offers for sale or has outstanding stock of which it is the issuer and which is redeemable at its net asset value. Accordingly, in the year of acquisition and each relevant subsequent year, stock in each of the FCs constituted “marketable stock” within the meaning of section 1296(e) and Treas. Reg. § 1.1296-2(f). The taxable year of each FC ends on Tax Year End. For each of Shareholder’s tax years in which it acquired an FC (“Acquisition Year”), the FC did not provide a Statement to its shareholders for its tax year that ended within the Acquisition Year.

Shareholder made a MTM election for each FC under section 1296 and Treas. Reg. § 1.1296-1 for each Acquisition Year as follows: (i) FC1: taxable year ended Date 7; (ii) FC2: taxable year ended Date 8; (iii) FC3: taxable year ended Date 9. Shareholder’s MTM election for each FC has remained in effect for each succeeding taxable year. With respect to each FC, for the Acquisition Year and each subsequent taxable year through the Year 2 Tax Year, Shareholder has included amounts in gross income under section 1296(a)(1) or deducted amounts under section 1296(a)(2) (collectively, the “MTM Inclusions”), as appropriate, and has adjusted its basis in each FC pursuant to section 1296(b) accordingly.²

At times, PFICs change their policies regarding issuing Statements. Since the Shareholder Acquisition Years, each FC has changed its historic policy regarding Statements and begun to issue Statements to their shareholders. As a result, other shareholders of the FCs who initially acquired stock after an FC changed its policy and have not made a MTM election with respect to the FC are able to make QEF elections. Shareholder would like to make QEF elections with respect to each of these FCs but cannot do so while its MTM elections are in effect. A MTM election can be revoked only with the consent of the Commissioner “upon a finding of a substantial change in circumstances” within the meaning of Treas. Reg. § 1.1296-1(h)(3).

In early Year 3, Shareholder contacted FC1 and FC2 and inquired whether the FC issued Statements. Each of FC1 and FC2 responded that it had prepared Statements for its tax year ended Date 10 and sent a copy of the Statement to Shareholder shortly

¹ Shareholder initially acquired an interest in FC3 on Date 4 but then sold its entire interest on Date 5. Shareholder did not make any elections with respect to FC3 at that time. Shareholder could not have made a MTM election at that time because it did not own stock in FC3 on the last day of its taxable year (Date 6), as required under Treas. Reg. § 1.1296-1(h)(1)(i). For purposes of this letter, references to Shareholder’s acquisition of FCS refer to Shareholder’s second acquisition of FC3 stock on Date 3.

² Shareholder disposed of its entire interest in FC3 after making the MTM election. Shareholder subsequently repurchased stock in FC3 in late Year 2. Shareholder did not include any MTM Inclusions in income for FC3 for tax years in which it did not own any FC3 stock. Under Treas. Reg. § 1.1296-1(b)(3), Shareholder’s MTM election for FC3 made for its tax year ended Date 9 applies to the FC3 stock it acquired during Year 2.

thereafter. A few months later, Shareholder's tax advisors informed Shareholder of the possibility of requesting a letter ruling to revoke its MTM elections on the basis that an FC's change in policy regarding issuing Statements was a "substantial change in circumstances." In the middle of Year 3, Shareholder successfully contacted FC3 and inquired whether FC3 issued Statements and whether FC3 had issued Statements in the past. FC3 responded that it issues Statements and that it first prepared Statements for its Year 1 tax year. Based on its inquiries, Shareholder determined that the FCs began to issue Statements as follows: (i) FC1: Statement dated Date 11; FC2: Statement dated Date 12; and FC3: Statement dated Date 13.

Shareholder represents that, if the ruling request is granted, it intends to file QEF elections for the FCs with its Year 3 Tax Year return.

RULINGS REQUESTED

Shareholder requests the consent of the Commissioner to revoke its MTM Elections with respect to each of the FCs at the end of the Year 2 Tax Year, with the following consequences:

- (1) Section 1296 ceases to apply to Shareholder with respect to each FC beginning with Shareholder's Year 3 Tax Year;
- (2) Pursuant to Treas. Reg. § 1.1296-1(g), solely for purposes of sections 1291 through 1298, Shareholder's holding period in each of the FCs is treated as beginning on Date 14;
- (3) Provided that Shareholder makes a valid QEF election for each of the FCs for its Year 3 Tax Year, each FC is a "pedigreed QEF" within the meaning of Treas. Reg. § 1.1291-1(b)(2)(ii) with respect to Shareholder; and
- (4) Shareholder's basis in each of the FCs includes the basis adjustments allowed pursuant to section 1296(b).

LAW

Section 1297(a) provides that the term "PFIC" means any foreign corporation if (i) 75 percent or more of the gross income of the corporation for the taxable year is passive income; or (ii) the average percentage of assets (as determined in accordance with section 1297(e)) held by the corporation during the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent. Section 1296(a) provides that, in the case of marketable stock in a PFIC that is owned (or treated as owned under section 1296(g)) by a United States person at the close of any taxable year, the United States person may elect to include in gross income the excess of the fair market value of the stock over its adjusted basis or, if the adjusted

basis exceeds the fair market value of the stock, deduct the lesser of the excess or the unreversed inclusions (MTM election).

Under section 1296(e)(2), in the case of any RIC issuing stock that is redeemable at its net asset value, all stock in a PFIC which it owns, directly or indirectly, shall be treated as marketable stock for purposes of section 1296.

Under section 1296(b)(1), the adjusted basis of stock in a PFIC is increased by the amount included in the gross income of the United States person under section 1296(a)(1) with respect to the stock and is decreased by the amount allowed as a deduction to the United States person under section 1296(a)(2) with respect to the stock.

Section 1296(k) provides that the MTM election will apply to the taxable year for which it is made and all subsequent taxable years unless the stock ceases to be marketable stock or the Secretary consents to the revocation of the election, and Treas. Reg. § 1.1296-1(h)(2)(i) provides that a MTM election will apply to the taxable year for which the election is made and remain in effect for each succeeding taxable year unless the election is revoked or terminated pursuant to Treas. Reg. § 1.1296-1(h)(3).

Treas. Reg. § 1.1296-1(h)(3)(i) provides that a United States person's MTM election will be terminated if (i) the PFIC stock ceases to be marketable; (ii) the United States person elects, or is required, to mark to market the PFIC stock under another provision of chapter 1 of the Code; or (iii) if the Commissioner, in the Commissioner's discretion, consents to the United States person's request to revoke its MTM election upon a finding of a substantial change in circumstances, which may include a foreign corporation ceasing to be a PFIC.

Treas. Reg. § 1.1296-1(h)(3)(ii) provides that, unless otherwise provided by the Commissioner, where a MTM election is revoked with the consent of the Commissioner, section 1296 will cease to apply beginning with the first taxable year of the United States person after the revocation is granted, unless otherwise provided by the Commissioner.

Treas. Reg. § 1.1296-1(f) provides that solely for purposes of sections 1291 through 1298, if section 1296 applied to stock with respect to the taxpayer for any prior taxable year, the taxpayer's holding period in the stock is treated as beginning on the first day of the first taxable year beginning after the last taxable year for which section 1296 applied.

Under section 1295(b)(1), a taxpayer may make a QEF election with respect to any PFIC for any taxable year of the taxpayer, and the election applies to all subsequent taxable years of the taxpayer with respect to the PFIC unless revoked by the taxpayer with the consent of the Secretary.

Treas. Reg. § 1.1295-1(g)(1) provides that, for each year of a PFIC ending during a taxable year of a shareholder to which the shareholder has a QEF election in effect, the PFIC must provide the shareholder with a Statement containing the information required by that section.

Treas. Reg. § 1.1295-1(i)(2)(i) provides that the Commissioner, in the Commissioner's discretion, may consent to a shareholder's request to revoke a QEF election upon a finding of a "substantial change in circumstances."

Under Treas. Reg. § 1.1295-1(i)(2)(ii), a shareholder must request consent to revoke a QEF election no later than 12 calendar months after the discovery of the substantial change in circumstances that is the basis for the shareholder's request to revoke the QEF election.

Treas. Reg. § 1.1291-1(b)(2)(ii) provides that a PFIC is a pedigreed QEF with respect to a shareholder if the PFIC has been a QEF with respect to the shareholder for all taxable years during which the corporation was a PFIC that are included wholly or partly in the shareholder's holding period of the PFIC stock.

Under section 851, the term RIC means any domestic corporation which (i) at all times during the taxable year is registered under the Investment Company Act of 1940, as amended, as a management company or unit investment trust, or has in effect an election under such Act to be treated as a business development company, or (ii) which is a common trust fund or similar fund excluded by section 3(c)(3) of such Act (15 U.S.C. 80a-3(c)) from the definition of "investment company" and is not included in the definition of "common trust fund" by section 584(a).

ANALYSIS

Revocation of MTM Elections.

Section 1296(h) provides that a shareholder's MTM election for a PFIC remains in effect until the PFIC stock is no longer marketable stock or the Secretary consents to the revocation of the election, and Treas. Reg. § 1.1296-1(h)(3)(i) allows the Commissioner, in the Commissioner's discretion, to consent to a shareholder's request to revoke an election upon a "substantial change in circumstances." As an example, the regulation provides that a foreign corporation ceasing to be a PFIC may be such a substantial change in circumstances. However, there are no additional examples regarding what constitutes a substantial change in circumstances or guidelines for requests to revoke a MTM election.

By way of comparison, section 1295(b)(1) similarly provides that a QEF election can be revoked with the consent of the Secretary, and Treas. Reg. § 1.1295-1(i)(2) allows the

Commissioner, in the Commissioner's discretion, to consent to a shareholder's request to revoke an election upon a "substantial change in circumstances." Just as with the revocation of the MTM election, there are no specific guidelines for what constitutes a substantial change in circumstances. However, Treas. Reg. § 1.1295-1(i)(2)(ii) requires that the shareholder must request consent to revoke its QEF election no later than 12 calendar months following the discovery of the substantial change in circumstances.

In order for Shareholder to make a QEF election for the FCs, the FCs would have had to issue Statements, as required under Treas. Reg. § 1.1295-1(g). However, none of the FCs had a practice of preparing or issuing statements to shareholders during their tax years that ended with Shareholder's Acquisition Years. As a result, Shareholder could not make QEF elections for the FCs in the Acquisition Years.

Subsequently, in early Year 3, Shareholder discovered that the FCs had changed their policies and were now preparing and issuing statements to shareholders, enabling shareholders who are U.S. persons (who do not have MTM elections in place) to make QEF elections. The decisions by the FCs to start issuing Statements were changes in the circumstances of the FCs that were outside the control of Shareholder. In addition, Shareholder requested consent to revoke the elections less than 12 calendar months from discovering the FCs' policy changes. Therefore, based on the facts described in this letter, the FCs beginning to issue Statements constitutes a substantial change in circumstances for purposes of Treas. Reg. § 1.1296-1(h)(3)(i), and Shareholder's MTM elections for the FCs are revoked.

Year of Revocation.

Treas. Reg. § 1.1296-1(h)(3)(ii) provides that, when a MTM election is revoked by request, the revocation is effective for the first taxable year of the shareholder following the consent of the Commissioner to the revocation, unless otherwise provided by the Commissioner. In this case, Shareholder is requesting that its MTM election with respect to each of the FCs be revoked as of the end of its Year 2 Tax Year, to be effective for the Year 3 Tax Year.

Shareholder's Year 3 Tax Year had already ended prior to the date of its request (and prior to the date of this letter), but it has not yet filed its Year 3 Tax Year return, which is not due until Date 15. Under the general rule of Treas. Reg. § 1.1296-1(h)(3)(ii), the revocation of the MTM elections for the FCs would be effective for Shareholder's Year 4 Tax Year. Based on the facts described, and because Shareholder has not yet filed its Year 3 Tax Year return, the revocation of Shareholder's MTM elections for the FCs is effective for the Year 3 Tax Year.

Holding Period.

Pursuant to Treas. Reg. § 1.1296-1(f), for purposes of sections 1291 through 1298, if section 1296 applied to stock with respect to a shareholder for any prior taxable year, the shareholder's holding period in the stock is treated as beginning on the first day of the first taxable year beginning after the last taxable year for which section 1296 applied. In this case, because the MTM election for each of the FCs is revoked as of the end of Shareholder's Year 2 Tax Year, the Year 2 Tax Year is the last year for which section 1296 applied. As a result, for purposes of sections 1291 through 1298, Shareholder's holding period with respect to each of the FCs begins on Date 14, the first day of Shareholder's Year 3 Tax Year.

Pedigreed QEF Status.

Treas. Reg. § 1.1291-1(b)(2)(ii) provides that a PFIC is a pedigreed QEF with respect to a shareholder if the PFIC has been a QEF with respect to the shareholder for all taxable years during which it was a PFIC that are included, wholly or partly, within the shareholder's holding period for the PFIC stock. As discussed above, through the application of Treas. Reg. § 1.1296-1(f), for purposes of sections 1291 through 1298, Shareholder's holding period with respect to the stock of each of the FCs begins on Date 14, the first day of Shareholder's Year 3 Tax Year. Shareholder has represented that if its ruling request is granted, it will make QEF elections for each of the FCs with its Year 3 Tax Year return. Therefore, provided that Shareholder properly makes QEF elections for each of the FCs with its Year 3 Tax Year return, each of the FCs would be a pedigreed QEF with respect to Shareholder.

Basis.

Section 1296(b) requires a shareholder who has made a MTM election to adjust its basis in its PFIC stock to increase it by the amount included in gross income under section 1296(a)(1) and decrease it by the amount deducted under section 1296(a)(2). There is no statutory basis or policy reason that these adjustments would cease to apply following the revocation of a MTM election, so these adjustments are not disregarded after a revocation of a MTM election.

CONCLUSIONS

Based on the information and representations submitted, Shareholder's request to revoke its MTM elections at the end of Year 2 is granted.

In addition, as a result of the revocation of Shareholder's MTM elections, we conclude that: (i) the revocation is effective as of the end of Shareholder's Year 2 Tax Year and section 1296 ceases to apply to Shareholder beginning with Shareholder's Year 3 Tax Year; (ii) pursuant to Treas. Reg. § 1.1296-1(f), solely for purposes of sections 1291

through 1298, Shareholder's holding period in each FC is treated as beginning on Date 14; (iii) each FC is a pedigreed QEF, within the meaning of Treas. Reg. § 1.1291-1(b)(2)(ii) with respect to Shareholder, provided that Shareholder properly makes a QEF election for each of the FCs for its Year 3 Tax Year; and (iv) Shareholder's basis in each of the FCs includes the basis adjustments made pursuant to section 1296(b).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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, copies of this letter are being sent to your authorized representative.

Sincerely,

Jeffery G. Mitchell
Chief, Branch 2
Office of the Associate Chief Counsel
(International)