Internal Revenue Service

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Department of the Treasury

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This is in reply to your April 2, 1998, request for a ruling to allow A to make a retroactive election under § 1.1295-3T(f) of the Income Tax Regulations. Additional information was submitted on July 8, 1998, and October 26, 1998.

RULING REQUESTED

A requests the consent of the Commissioner of Internal Revenue to make a retroactive election to treat stock owned by A in B, a passive foreign investment company (PFIC), as stock in a qualified electing fund (QEF) for the first taxable year and each succeeding year that A owned stock in B.

FACTS

A is a publicly-traded, widely-held corporation. A uses the accrual method of accounting with a taxable year ending December 31. On or around May 3, 1990, A purchased 14.667 percent of the stock of B, a PFIC.

Assuming B was a PFIC for the 1990 taxable year, the first taxable year during which A owned stock in B, a pedigreed QEF election would have had to have been made with respect to A's interest in B by September 15, 1991, the extended due date for the 1990 consolidated federal income tax return that included A.

For all affected years, C has served as independent accountants for A. C performed a financial statement audit of A for its 1990 taxable year more than six months before the filing of the 1990 consolidated Federal income tax return that included A. In connection with such audit, the tax department at C reviewed A's tax position and was aware in 1990 that A had invested in B. C has prepared all federal income tax returns that included A for all years after 1990. In its role as independent accountants, C has been responsible for providing advice to A on various tax matters. A has fully relied on C to advise it as to the consequences of making, and failing to make, all available elections on A's Federal income tax returns from and including the 1990 taxable year. A has never had a tax department; C therefore has been responsible for ensuring that A is fully informed of the consequences of alternative tax reporting positions.

C was aware that A and the other shareholders in B had entered into a joint venture agreement to purchase B. In addition, C was aware that B was a foreign corporation that most likely would not be operating a license or otherwise engaged in an active trade or business for a period of years subsequent to A's first purchase of B stock. C was also aware that A would be required to contribute cash to B prior to the commencement of an active trade or business. C did not advise A that it should consider making a QEF election or the effect of making, or failing to make, such election. C reviewed the Federal income tax return that included A for the 1990 taxable year. A was unaware of the existence of the PFIC provisions of the Code and was not apprised of such provisions by C after C reviewed the 1990 tax return (or prepared the subsequent years' tax returns).

In July 1995, A asked C to review A's Federal income tax returns to see what, if any, elections were made with respect to A's investment in B. After reviewing the tax returns, C informed A that no QEF elections had been made.

As a result of making a retroactive QEF election, A will include in income the following amounts of deemed distributions based on A's pro rata share of B's earnings and profits:

1990	$s
1991	$t
1992	$u

1993	$v
1994	$w
1995	$0
1996	$0

In calendar year 1990, A was a member of an affiliated group that filed a consolidated federal income tax return. This consolidated tax return reflected current year taxable income which was completely offset by tax loss carryforwards for regular tax purposes. For AMT purposes, the loss carryforward utilized was limited to 90 percent of the tentative AMT income; thus, an increase in AMT income of $s results in an increase in AMT tax due of $x.

The deemed distribution of PFIC earnings for 1991 to 1994 would have been reflected on A's consolidated tax returns. In each year, 1991 to 1994, A had a consolidated net operating loss (NOL). Thus, the deemed distributions for those 4 years reduces A's consolidated NOL carryforward by an aggregate amount of $y. In 1995, A had taxable income which has been completely offset by a combination of loss carryforwards from 1991 to 1994 and a loss carryback from 1996. As a result of the reduction in A's NOL's from the deemed distributions for 1991 to 1994, A's 1995 taxable income, prior to any NOL carryback is increased by $y resulting in a deficiency for that year. The deficiency would have been satisfied in full by A's NOL carrybacks from 1996. However, A owes interest on $y from the due date, without extensions, of A's 1995 federal income tax return to the date that the deficiency was satisfied by the NOL carryback from taxable year 1996. Furthermore, A's NOL carryforward should be reduced by $y. A has represented that on its 1997 federal income tax return it has reduced its NOL carryforward by $y.

The affiliated group that included A in calendar year 1990 had a consolidated tax loss in 1991, and consolidated taxable income in 1992, 1993, and 1994. The affiliated group's tax loss carryforward completely offset its taxable income in 1992 and 1993; in 1994, the tax loss carryforward was completely utilized. Thus, the $s of NOL reduction in 1990 results in a $s increase in the affiliated group's 1994 taxable income and an increase in the group's tax for 1994 of $z.

LAW AND ANALYSIS

Section 1295(a) provides that any PFIC shall be treated as a QEF with respect to the taxpayer if (1) an election by the taxpayer under § 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 gain of such company, and otherwise

carrying out the purposes of Subpart B. Section 1295(b)(1) provides that a taxpayer may make an election with respect to any PFIC for any taxable year of the taxpayer. Section 1295(b)(2) states that an 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 of the tax imposed by this chapter for such taxable year. To the extent provided in regulations, such an election may be made later than as required in the preceding sentence where the taxpayer reasonably believed that the company was not a PFIC.

Section 1.1295-3T allows a shareholder of a PFIC to make a retroactive § 1295 election where the shareholder reasonably believed that the foreign corporation was not a PFIC or the shareholder demonstrates that it reasonably relied on the advice of a qualified tax professional.

Section 1.1295-3T provides two sets of rules for making a retroactive election. The first set of rules allow a shareholder of a PFIC that meets certain conditions to make a retroactive election without obtaining the consent of the Commissioner. §§ 1.1295-3T(c) - (e). A has not met the conditions for this election. The second set of rules allows a shareholder to make a retroactive election only after the shareholder has obtained the Commissioner's consent. § 1.1295-3T(f).

The Commissioner will grant relief under § 1.1295-3T(f) if four requirements are satisfied. The first requirement is that the shareholder reasonably relied on a qualified tax professional, that is, 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 § 1295 election. The 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 the availability of a § 1295 election, or knew or reasonably should have known that the qualified tax professional 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 relevant facts and circumstances.

A relied on C, a qualified tax professional, for all its advice on various tax matters, including the consequences of making or failing to make all available elections, including the § 1295 QEF election, on A's federal income tax returns. A never had a tax department. A did not know, nor should it reasonably have known, that B was a PFIC nor did A know about the availability of a § 1295 election. Finally, C did not inform A that B was a PFIC or that A could make a § 1295 election. Thus,

A reasonably relied on a qualified tax professional and has satisfied the first requirement.

The second requirement of § 1.1295-3T(f) is that granting consent not prejudice the interests of the United States government. Under § 1.1295-3T(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 § 1295 election by the election due date. The time value of money is taken into account for purposes of this computation. Because an aggregate federal income tax liability of $x of AMT and $z of regular tax (plus interest in each case) constitutes a de minimis amount of tax liability, because A has agreed to pay interest on the $y amount for the 1995 taxable year, and because A has reduced its NOL carryforward by $y, the interests of the U.S. government will not be prejudiced by allowing A to make a retroactive § 1295 election.

The third requirement for a special consent election 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. A has made its special consent election request before the issue was raised on audit and therefore has satisfied the third requirement.

The fourth and final requirement for a special consent election is that the procedural requirements set forth in § 1.1295-3T(f)(4) must be met. Affidavits meeting the requirements set forth in § 1.1295-3T(f)(4) as to C's failure to inform A of its need to make a QEF election have been submitted by A. A therefore has met the procedural requirements of § 1.1295-3T(f)(4).

CONCLUSION

A has satisfied the requirements of a special consent election. Consent will therefore be granted allowing A to make a retroactive election under § 1.1295-3T(f), provided that the requirements of § 1.1295-3T(g)(2) are met. In order to meet those requirements, A must file amended returns for all open years to reflect the making of the QEF election, including paying interest on the deficiency that results in A's 1995 taxable year. Furthermore, A has already reduced its NOLs by $y on its 1997 Federal income tax return.

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.

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.

Sincerely,

Philip L. Garlett

PHILIP L. GARLETT
Senior Technical Reviewer
(International)