Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:INTL:B2-PLR-105406-00
Date:
October 1, 2002

In Re:

Legend:

A =
A2 =
A3 =
B =

C =
D =
FC1 =

FC2 =
Country X =
Country Y =
Country Z =

Dear :

This is in response to your letter dated November 3, 2000, and supplemental information submitted on September 19, 2001, requesting a determination that A, the former common parent of a consolidated group that included B, is eligible to make retroactive elections on behalf of B, under Treasury Regulation § 1.1295-3, to treat certain passive foreign investment companies ("PFICs") as qualified electing funds ("QEFs") with respect to B. In addition, you also requested a determination that A is eligible to make a deemed dividend election on behalf of B for one of these PFICs, pursuant to Treas. Reg. § 1.1291-9.

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

B is a U.S. corporation and a calendar year taxpayer. B owns 100 percent of FC1, a Country X corporation, and over 50 percent of FC2, a Country Y corporation. B's ownership of FC1 and FC2 has not changed since acquisition or formation, and is described below.

B acquired FC1 on August 19, 1987, to assist in the performance of a contract with an unrelated Country Z corporation. Subsequently, FC1 became a holding company for the common parent's minority investment in C, a Country Y company. Since its acquisition, FC1 has been a controlled foreign corporation ("CFC") within the meaning of section 957.[1]

On November 28, 1990, FC1 and D, then an unrelated Country Y corporation, formed FC2 by contributing a 4.5 percent interest in C. In December 1995, FC1 and D contributed additional quotas of C into FC2's capital and, thus, increased FC2's ownership in C to 10 percent. On March 12, 1996, B bought 10 shares of D, thereby increasing its ownership (direct and indirect) in FC2 to over 50 percent and converting FC2 into a CFC. Since then, FC2 has been a CFC within the meaning of section 957.

Both FC1 and FC2 are PFICs under section 1298(b)(1). FC1 is a PFIC with respect to B's 1987 through 1990 tax years, and FC2 is a PFIC with respect to B's 1990 and 1991 tax years. The PFIC status of FC1 and FC2 during these year resulted from their ownership in C, which was in its start-up phase. B was not aware of these corporations' PFIC status, and thus, did not make QEF elections under Treas. Reg. § 1.1295-1. The PFIC status of FC1 and FC2 has not been raised by the Service on audit for any taxable year with respect to A and B.

As a result of corporate reorganizations, B has joined in the filing of consolidated returns with three different common parents: A from July 15, 1983 to March 31, 1994, A2 from April 1, 1994 to December 30, 1999; and A3 from December 31, 1999 to the present. From 1983 to 1994, as B's common parent, A was responsible for preparing U.S. federal tax returns for the consolidated group that included B. A's tax department was composed of approximately 21 tax professionals including an international tax manager. At no time did A's tax department inform B of its need to make a QEF election for FC1 and FC2, nor of the tax ramifications for failing to make such an election.

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[1] All section references are to the International Revenue Code of 1986 or the Treasury Regulations thereunder.

A2's tax department performed an analysis in December 1999 that indicated FC1 most likely was a PIFC in 1987 and 1988 and definitely was a PFIC in 1989, and that FC2 was a PFIC in 1990 and 1991. Accordingly, a decision was made to seek relief under the special consent procedures of Treas. Reg. § 1.1291-3(f). A3, the common parent at the close of 1999, initially sought this ruling and was later replaced by A, the common parent for the years for which relief is sought.

RULINGS REQUESTED

A, on behalf of B, requests the consent of the Commissioner of Internal Revenue Service:

(i) to make a retroactive QEF election under Treas. Reg. § 1.1295-3(f) with respect to FC1 for B's 1989 tax year, and with respect to FC2 for B's 1990 tax year; and

(ii) to make a deemed dividend election under section 1291(d)(2)(B) with respect to FC1 for B's 1989 tax year.

LAW AND ANALYSIS

Treasury Regulation § 1.1502-77(a) provides that, for any year in which a consolidated return is filed, the common parent for that year is the sole agent for the affiliated group with respect to all matters that relate to the group's federal income tax liability for the consolidated return year, with certain exceptions not relevant in this case. In this request, the elections are to be made for B's 1989 and 1990 tax years. During those tax years, A was the common parent of the consolidated group of which B was a member. Thus, A is the appropriate party for requesting the rulings.

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 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. 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. Section 1295(b)(2).

Under Treas. Reg. §1.1295-3(f), the taxpayer may request the consent of the

Commissioner to make a retroactive QEF election for a taxable year. The Commissioner will grant relief under Treas. Reg. § 1.1295-3(f) only if four conditions are satisfied. The first requirement is that 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 section 1295 election. Treas. Reg. §1.1295-3(f)(2) 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 knew of the availability of a section 1295 election. In addition, a shareholder cannot claim reliance upon a tax professional if he 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.

During the years at issue, 1987 through 1990, B relied on A for advice concerning international aspects of U.S. taxation pertaining to B, including the consequences of making or failing to make all available elections. A's tax department was competent to render tax advice with respect to stock ownership of a foreign corporation and had access to all the relevant facts and circumstances. A's tax department failed to identify FC1 and FC2 as PFICs and therefore failed to advise B of the consequences of making or failing to make a QEF election. Thus, B reasonably relied on a qualified tax professional within the meaning of Treas. Reg. § 1.1295-3(f)(1)(i) and (2) for the taxable years at issue.

The second requirement of Treas. Reg. § 1.1295-3(f) is that granting consent will not prejudice the interest 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 this case, B's 1987 taxable year is closed. Provided that A, on behalf of B, enters into a closing agreement with the Commissioner as described in Treas. Reg. § 1.1295-3(f)(3)(ii), to eliminate any prejudice to the interests of the government with respect to B's tax liability for its closed taxable year, the interests of the U.S. government will not be prejudiced by allowing A to make, on behalf of B, a retroactive section 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. Treas. Reg. §1.1295-3(f)(1)(iii). A, on behalf of B, has made the special consent election before the issue was raised on audit.

The final requirement for a special consent election is that the procedural requirements set forth in Treas. Reg. § 1.1295-3(f)(4) must be met. Affidavits meeting the requirements set forth in Treas. Reg. § 1.1295-3(f)(4)(ii) and (iii) as to the failure of A and A2 to inform B of its need to make QEF elections have been submitted and A, on behalf of B, has otherwise satisfied the procedural requirements of Treas. Reg. § 1.1295-3(f)(4).

A, on behalf of B, has also requested consent to make a deemed dividend election under section 1291(d)(2)(B) for B's 1989 tax year with respect to FC1. Treas. Reg. § 1.1295-3(g)(4)(i) provides that if a foreign corporation for which the shareholder makes a retroactive election will be treated as an unpedigreed QEF with respect to the shareholder, the shareholder may make an election under section 1291(d)(2) to purge its holding period of the years before the effective date of the retroactive election. In general, an unpedigreed QEF is a PFIC that has been a QEF with respect to the shareholder for at least one, but not all, of the 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. Treas. Reg. § 1.1291-9(j)(2)(iii). The shareholder of a PFIC may make an election under section 1291(d)(2)(B) if the PFIC becomes a QEF for a post-1986 taxable year, the shareholder holds stock of the PFIC on the first day of such taxable year and, the PFIC is a CFC.

Treas. Reg. § 1.1291-9 provides rules for making the deemed dividend election. Under this election, the shareholder of an unpedigreed QEF includes in income as a dividend the shareholder's pro rata share of the post-1986 earnings and profits of the PFIC attributable to stock held on the qualification date. The qualification date is the first day of the PFIC's first taxable year as a QEF. Treas. Reg. § 1.1291-9(e). The shareholder makes the deemed dividend election in the shareholder's return for the taxable year that includes the qualification date. Treas. Reg. §1.1291-9(d). The deemed dividend is taxed as an excess distribution received on the qualification date. Treas. Reg. §1.1291-9(a)(1).

FC1 is a CFC, as defined in section 957(a), and has been wholly owned by B since its incorporation in 1987. In this case, if granted, the retroactive QEF election for FC1 will be effective for B's 1989 taxable year. Because B's holding period in the stock of FC1 includes taxable years prior to 1989, FC1 will be an unpedigreed QEF with respect to B. To purge B's holding period in the stock of FC1, under section 1291(d)(2)(B), the deemed dividend election must be made in its return for the 1989 taxable year, which is the taxable year that includes the qualification date, *i.e.* January 1, 1989.

Based on the information submitted and representations made:

(1) A, on behalf of B, will be allowed to make a retroactive election for B's 1989 taxable year with respect to FC1, and for B's 1990 taxable year with respect to FC2, under Treas. Reg. § 1.1295-3(f) provided a closing agreement is entered into with the Commissioner to eliminate any prejudice to the interests of the U.S. government with respect to B's closed tax year. A and B shall comply with the rules under Treas. Reg. § 1.1295-3(g) regarding the time and manner for making the retroactive QEF election.

(2) A, on behalf of B, will be allowed to make a deemed dividend election under Treas. Reg. § 1.1291-9(a) for B's 1989 taxable year with respect to FC1. In making the deemed dividend election, A and B shall comply with the rules under Treas. Reg. § 1.1291-9(c) and (d) regarding the time and manner for making the election.

This private letter ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be sued 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 ruling is forwarded to your first representative.

Sincerely,
Valerie A. Mark Lippe
Senior Technical Reviewer, CC:INTL:Br2
Office of Associate Chief Counsel
(International)