Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:INTL:Br2, PLR-113987-00

In Re:

Date:
March 24, 2003

LEGEND:

Taxpayer	=
FP	=
Corp A	=
Corp B	=
Corp C	=
Corp D	=
Corp E	=
Corp F	=
Year 1	=
Year 2	=

Dear :

This private letter ruling is in response to your request dated June 6, 2000, for a determination that the Taxpayer has sufficiently satisfied the requirements under I.R.C. § 1295 to treat certain investments in passive foreign investment companies (PFICs) as qualified electing funds (QEFs) based on the doctrine of substantial compliance.

The rulings contained in this letter are based upon information and representations submitted by Taxpayer, and accompanied by a penalty of perjury statement executed by an appropriate party.

Taxpayer is a domestic limited partnership that was organized on August 1, Year 1, to act as the general partner of FP, a limited partnership organized under the laws of . In addition to Taxpayer, FP has other domestic and foreign partners. The partners of Taxpayer consist of eleven U.S. persons.

During Year 1, FP acquired the stock of three foreign corporations (Corp A, Corp B and Corp C) that are treated as PFICs under section 1297(a).[1] By virtue of Taxpayer's ownership in FP, Taxpayer is an indirect shareholder of Corp A, Corp B and Corp C for purposes of the PFIC provisions. Section 1298(a)(3). For taxable year ended December 31, Year 1, FP elected to treat Corp A, Corp B and Corp C as QEFs and filed a Form 8621 for each respective entity with FP's U.S. partnership income tax return. FP also attached the PFIC annual information statements for Corp A, Corp B and Corp C to Forms 8621 for such taxable year.

During Year 1, Corp C acquired the stock of three foreign corporations (Corp D, Corp E and Corp F) that are treated as PFICs under section 1297(a). Through its direct ownership of Corp C, FP is an indirect shareholder of Corp D, Corp E and Corp F. Section 1298(a)(2). Hence, Taxpayer, as a partner of FP, is also an indirect shareholder of Corp D, Corp E and Corp F. Section 1298(a)(3). For taxable year ended December 31, Year 1, neither Taxpayer nor FP filed a Form 8621, with respect to its indirect ownership of Corp D, Corp E and Corp F, to elect QEF status for such entities.

For taxable year ended December 31, Year 2, FP filed Forms 8621 for Corps A through F with its U.S. partnership income tax return. The Forms 8621 for Corp D, Corp E and Corp F contained the election to treat such foreign corporations as QEFs. The Forms 8621 also included the PFIC annual information statements for Corps A through F for that taxable year. No QEF election was made by Taxpayer, or its eleven U.S. partners, with respect to Corp D, Corp E or Corp F for taxable year ended December 31, Year 2.

Taxpayer has represented that for taxable years ended December 31, Year 1 and Year 2, FP passed through the ordinary earnings and net capital gain of Corps A through F to its partners, including Taxpayer, on the Schedules K-1 and that Taxpayer in turn passed through the income earned from FP, including the ordinary earnings and net capital gain of Corps A through F, to its eleven U.S. partners on the Schedules K-1, as if a valid QEF election had been made.

Section 1295(a) provides that a PFIC shall be treated as a QEF with respect to the taxpayer if an election is made by that taxpayer in accordance with section 1295(b) and the PFIC complies with the requirements prescribed by the Secretary for determining the ordinary earnings and net capital gain of the PFIC and for carrying out the purpose of the PFIC provisions. Section 1295(b)(2) provides that the QEF election must be

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[1] Pub.L. No. 105-34, Sec. 1121, (1997) redesignated the provisions contained under section 1296 of the Code as section 1297, effective as of August 5, 1997. For purposes of this document, the former section 1296 will be referred to herein as section 1297.

made on or before the due date, as extended, for filing the shareholder's income tax return for the taxable year for which the election is made. An election is effective for the shareholder's taxable year for which it is made and all subsequent taxable years of the shareholder unless revoked by the taxpayer with the consent of the Secretary. Section 1295(b)(1).

During the taxable years at issue, the rules for making and maintaining a QEF election were set forth under Notice 88-125, 1988-2 C.B. 535. The rules have since been incorporated into Treas. Reg. §1.1295-1. Notice 88-125 provided that any U.S. person that was a shareholder of a PFIC could make a QEF election by attaching a "Shareholder Section 1295 Election Statement", a "PFIC Annual Information Statement" and a Form 8621 (Return by a Shareholder of a PFIC or QEF) to a timely filed income tax return in which the shareholder included its pro rata share of the PFIC's ordinary earnings and net capital gain for the year to which the election applied. Notice 88-125 provided that in cases involving a chain of ownership, only the first U.S. person that was a direct or indirect shareholder of a PFIC could make the QEF election.

In this case, FP made the QEF election for Corp A, Corp B and Corp C for taxable year ended December 31, Year 1, and for Corp D, Corp E and Corp F for taxable year ended December 31, Year 2. However, under the rules of Notice 88-125, a foreign person is not entitled to make the QEF election, and thus, the election should not have been made by FP. Rather, the QEF election should have been made by the first U.S. person that is the direct or indirect shareholder of Corps A through F, and therefore, the elections should have been made by Taxpayer.

Under certain circumstances, when taxpayers have failed to fulfill the requirements for making an election, the courts have nevertheless treated the election as valid, provided that the regulatory requirements were procedural and "the essential statutory purposes have been fulfilled." American Air Filter Co. v. Commissioner, 81 T.C. 709, 719 (1983). The courts have considered the following factors in determining whether the taxpayer is entitled to the tax treatment of certain elections when the taxpayer has failed to fully comply with the regulatory requirements for making the election:

> [1] [W]hether the taxpayer's failure to comply fully defeats the purpose of the statute; [2] whether the taxpayer attempts to benefit from hindsight by adopting a position inconsistent with his original action or omission; [3] whether the Commissioner is prejudiced by the untimely election; [4] whether the sanction imposed on the taxpayer for the failure is excessive and out of proportion to the default; and [5] whether the regulation provided with detailed specificity the manner in which an election was to be made.

Id. at 719-20

Whether Taxpayer is treated as having made the QEF elections depends upon the extent to which it satisfies the doctrine of substantial compliance. The first consideration is whether Taxpayer's failure to make the QEF elections defeated the purposes of sections 1293 and 1295. The purpose of the section 1295 election is to notify the Commissioner that Taxpayer elected to treat certain PFICs as QEFs and to be subject to taxation and the annual reporting rules of sections 1293 and 1295. Although the Forms 8621 were filed by the wrong party (FP), such forms indicated that

Corp A, Corp B and Corp C were intended to be treated as QEFs for the taxable year ended December 31, Year 1.

However, with respect to Corp D, Corp E and Corp F, there is no indication that those entities were intended to be treated as QEFs for the taxable year ended December 31, Year 1. While Corp C acquired the stock of Corp D, Corp E and Corp F in Year 1, neither FP nor Taxpayer filed a Form 8621 for those entities for the taxable year ended December 31, Year 1. Rather, the Form 8621 for each respective corporation was filed with FP's U.S. partnership income tax return for the taxable year ended December 31, Year 2. The Forms 8621 indicated that FP made the QEF elections for Corp D, Corp E and Corp F for Year 2 rather than Year 1.

The Forms 8621 for taxable years ended December 31, Year 1 for Corps A through C, and Year 2 for Corps D through F, contained the information required by the PFIC annual information statement reporting rules of Notice 88-125. Furthermore, for those two taxable years, FP included in gross income the ordinary earnings and net capital gain of Corps A through F, as required by section 1293. FP passed through those earnings and the capital gain to Taxpayer, who in turn passed through such amounts to its eleven U.S. partners. Accordingly, Taxpayer's failure to make the QEF election did not defeat the purposes of sections 1293 and 1295.

Another relevant factor is that Taxpayer is not presently attempting to benefit from hindsight because it is not taking a position that is inconsistent with its original tax return for taxable years ended December 31, Year 1 and Year 2.

A final relevant factor is that the Commissioner would not be prejudiced by Taxpayer's failure to make the timely QEF elections for Corps A through F. Taxpayer's partners represent that they have reported on their respective returns, for the tax years at issue, the proper amount of ordinary earnings and net capital gain of Corps A through F. To support this representation, Taxpayer and its partners have provided tax return information to the Commissioner for review. Based upon this review, the Commissioner is satisfied that granting consent to make retroactive QEF elections would not prejudice the interests of the U.S. government. Thus, although the wrong entity made the QEF election, the essential statutory purposes of section 1295 and 1293 have been fulfilled.

Based on the facts herein, Taxpayer substantially complied with the requirements of sections 1293 and 1295, and shall be treated as having properly made the QEF elections for Corp A, Corp B and Corp C, effective for taxable year ended December 31, Year 1, and for Corp D, Corp E and Corp F, effective for taxable year ended December 31, Year 2. Because Corp D, Corp E and Corp F were PFICs in Year 1 and their QEF election is retroactive only to Year 2, they will be unpedigreed QEFs, within the meaning of Treas. Reg. §1.1291-9(j)(2)(iii), unless Taxpayer makes an election under section 1296(d)(2), with respect to these corporations, to purge the non-QEF years from Taxpayer's holding period.

This private letter ruling does not express an opinion about whether FP or Taxpayer properly complied with the section 1295 annual reporting requirements, or the section 1293 annual income inclusions, with respect to Corps A through F for taxable years ended after Year 2.

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 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 ruling is forwarded to Taxpayer and its second representative.

Sincerely,

By: _____

Valerie A. Mark Lippe
Senior Technical Reviewer, CC:INTL:2
Office of Associate Chief Counsel
(International)

cc: