

Section 1295.—Qualified Electing Fund

26 CFR 1.1295-1T: *Qualified electing funds (temporary).*

T.D. 8750

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

General Rules for Making and Maintaining Qualified Electing Fund Elections

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary and final regulations.

SUMMARY: This document contains temporary regulations that provide guidance to a passive foreign investment company (PFIC) shareholder that makes the election under section 1295 (section 1295 election) to treat the PFIC as a qualified electing fund (QEF). This document also contains temporary regulations that provide guidance for shareholders that wish to make a section 1295 election that will apply on a retroactive basis (retroactive election). In addition, this document contains a temporary regulation that provides guidance under section 1291 to a PFIC shareholder that is a tax-exempt organization. Temporary regulations are needed to provide taxpayers additional time to satisfy certain requirements to make the section 1295 election. The text of these temporary regulations also serves as the text of proposed regulations REG-115795-97, page 33. In addition, this document removes § 1.1291-9(i)(1) of the final regulations, and amends § 1.1297-3T. References to sections 1296 and 1297 in this document are references to sections 1296 and 1297 as in effect before the effective date of section 1122(a) of the Tax Relief Act of 1997.

DATES: These regulations are effective January 2, 1998.

For dates of applicability, see §§ 1.1291-1T(e)(2), 1.1293-1T(a)(2)(ii),

1.1293-1T(c)(3), 1.1295-1T(k), 1.1295-3T(h), and § 1.1297-3T(c)(3) of these regulations.

FOR FURTHER INFORMATION CONTACT: Gayle Novig, (202) 622-3840 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collections of information contained in these regulations have been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545-1555. Responses to these collections of information are mandatory.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

For further information concerning these collections of information, and where to submit comments on the collections of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to REG-115795-97.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under sections 1291, 1293, 1295, and 1297 of the Internal Revenue Code. Sections 1291, 1293, 1295, and 1297 were added by the Tax Reform Act of 1986, effective for taxable years of foreign corporations beginning after December 31, 1986. As originally enacted, the section 1295 election was an election made by the PFIC. The Technical and Miscellaneous Revenue Act of 1988 (TAMRA) amended section 1295, effective for taxable years

of foreign corporations beginning after December 31, 1986, to change the section 1295 election to a shareholder-by-shareholder election. Sections 1291, 1293, and 1297 also were amended by TAMRA; sections 1293 and 1297 were further amended by the Omnibus Budget Reconciliation Act of 1993. Section 1297 also was amended by the Revenue Reconciliation Act of 1989 and the Small Business Job Protection Act of 1996. In addition, the Taxpayer Relief Act of 1997 (1997 TRA) amended section 1 to provide categories of long-term capital gain and the maximum rates of tax to which the categories are subject. In certain cases, this amendment affects the calculation of net capital gain for purposes of section 1293.

Guidance for making the election under section 1295 was first provided on March 2, 1988, in the **Federal Register** (53 F.R. 6770), with the publication of temporary regulations (T.D. 8178) relating to the section 1295 election. These temporary regulations provided guidance to PFICs making the section 1295 election and therefore became obsolete with the 1988 amendment to section 1295. The Internal Revenue Service published Notice 88-125, 1988-2 C.B. 535, to provide guidance to shareholders making the section 1295 election under section 1295, as amended. Notice 88-125 was an administrative pronouncement, as that term is used in § 1.6661-3(b)(2) of the Income Tax Regulations, and taxpayers could rely on Notice 88-125 to the same extent as a revenue ruling or a revenue procedure. Notice 88-125 stated that taxpayers could rely on the notice until regulations were published, and that those regulations would be effective for taxable years beginning after December 31, 1986.

Proposed regulations published April 1, 1992 (57 F.R. 11024), provide a general rule regarding the application of section 1291 to a PFIC shareholder that is an organization exempt from tax under chapter 1. In addition, these proposed regulations provide general rules regarding the application of section 1293 and special rules regarding the application of section 1295, including rules with respect to transfers of PFIC stock subject to a section 1295 election. Proposed regulation § 1.1295-2, published December 24, 1996 (61 F.R.

67752), permits certain shareholders to make a special section 1295 election with respect to certain preferred stock. Proposed regulation § 1.1293-2, also published December 24, 1996 (61 F.R. 67752), provides the special inclusion rules applicable to shareholders that make the special section 1295 election with respect to their preferred stock.

Temporary regulations § 1.1297-3T, published March 2, 1988 (53 F.R. 6770), provides guidance for making the deemed sale election under section 1297(b)(1) to purge the PFIC taint from stock of a foreign corporation that is treated as stock of a PFIC under section 1297(b)(1). Section 1.1291-9(i)(1) of the regulations, published December 27, 1996 (61 F.R. 68149), provides that the deemed dividend election rules of § 1.1291-9 do not apply to elections made under section 1297(b)(1). A similar rule had been provided in temporary regulations published April 1, 1992 (57 F.R. 10992). The temporary regulations, which had been effective April 1, 1992, sunset April 1, 1995.

Treasury and the Service believe that immediate guidance in the form of temporary regulations regarding the section 1295 election is necessary. First, the regulations provide significant new QEF election procedures that are beneficial to taxpayers. For example, the regulations provide procedures for both retroactive and protective elections. The benefits provided by these changes may be jeopardized, or simply unavailable (as a result of closed taxable years), if taxpayers cannot immediately rely on them. Second, although the regulations embody guidance already provided in Notice 88-125, the regulations significantly reduce the burden for making and maintaining the election and clarify, most often in favor of taxpayers, significant ambiguities left by the Notice. Treasury and the Service believe that the benefits of immediate guidance significantly outweigh any advantage obtained by issuing the regulations in proposed form only because these temporary regulations prevent prejudice to taxpayers as a consequence of a further delay in guidance and because they benefit taxpayers by providing additional time to make certain elections. Finally, the temporary regulations provide guidance concerning the manner in which section 1(h), which was added to the Code by 1997

TRA, effective for taxable years ending after May 6, 1997, applies to determine the net capital gain of the PFIC and the QEF shareholder's pro rata share of the net capital gain. Therefore, it would be impractical and contrary to public interest to issue this Treasury decision with prior notice under section 553(b) of title 5 of the United States Code.

Explanation of Provisions

A foreign corporation is a passive foreign investment company (PFIC) for a taxable year if the foreign corporation satisfies either the income or asset test of section 1296(a) for that year. A foreign corporation is a PFIC under the income test if 75 percent or more of its gross income for its taxable year is passive, or investment-type, income. Alternatively, under the asset test, a foreign corporation is a PFIC if 50 percent or more of the average fair market value of its assets during its taxable year are assets that produce or are held for the production of passive income. A shareholder of a foreign corporation that qualifies as a PFIC is subject to the interest charge regime of section 1291 with respect to certain distributions by the PFIC and certain dispositions of its stock. Generally, a shareholder may avoid the interest charge regime by making a timely election under section 1295 to treat a PFIC as a QEF, in which case the shareholder will be taxable annually under section 1293 on its pro rata shares of the ordinary earnings and net capital gain of the PFIC. Under section 1295(a), a section 1295 election will apply with respect to the PFIC if the PFIC complies with requirements prescribed by the Secretary for purposes of determining the ordinary earnings and net capital gain of the PFIC and otherwise carrying out the purposes of the PFIC provisions.

Section 1295(b)(1) provides that a shareholder may make a section 1295 election with respect to a PFIC for any taxable year of the shareholder (shareholder election year). Once made, the election will apply to that year and to all subsequent years of the shareholder unless revoked with the consent of the Secretary. Section 1295(b)(2) prescribes the time for making the election. In general, for the section 1295 election to be applicable to a taxable year, the shareholder

must make the election by the due date, as extended under section 6081, for the shareholder's return for that taxable year. However, to the extent provided in regulations, a section 1295 election may be made for a taxable year after the time required if the shareholder failed to make a timely election because the shareholder reasonably believed that the foreign corporation was not a PFIC.

This document provides temporary regulations that interpret sections 1291, 1293, 1295, and 1297. In particular, the temporary regulations incorporate the rules of Notice 88-125, with certain modifications. The temporary regulations also clarify the rules of the notice and proposed regulation § 1.1295-1(b) with respect to the application of section 1295 to options, lapse of PFIC status, cessation of ownership of PFIC stock, transfer of stock subject to a section 1295 election to a pass through entity, and tax-exempt organizations. The temporary regulations also provide rules regarding invalidation, termination and revocation of a section 1295 election. In addition, the temporary regulations introduce rules for making a retroactive election. Finally, the temporary regulations provide guidance concerning the application of the deemed dividend election rules to elections under section 1297(b)(1).

1. Rules of Notice 88-125.

Temporary regulation § 1.1295-1T(c) through (g) adopts the rules provided in Notice 88-125, with certain modifications. These modifications reflect certain comments received with respect to the notice.

Notice 88-125 describes the requirements a shareholder must satisfy to make and maintain a section 1295 election. In particular, each year the shareholder must file Form 8621 with its income tax return and attach a PFIC Annual Information Statement (described below). In the year of election, the shareholder also must attach a Shareholder Election Statement. Notice 88-125 requires satisfaction of the election and annual reporting requirements with respect to each PFIC for which the shareholder makes the section 1295 election.

Commenters indicated that these election and annual reporting requirements

are burdensome, especially if the shareholder is making the election with respect to many foreign corporations. In response to the comments, the temporary regulations change these requirements to reduce the burden on the electing shareholder. First, the temporary regulations eliminate the need to file a Shareholder Election Statement. Second, the temporary regulations eliminate the need to file a copy of the PFIC Annual Information Statement with Form 8621 and require instead that the shareholder retain a copy of the PFIC Annual Information Statement for production upon examination by the Service. Thus, to make and maintain a section 1295 election, the shareholder need only file Form 8621 for each PFIC on an annual basis and maintain records to support the information entered on that form.

Notice 88-125 imposes certain requirements on PFICs and on intermediaries through which shareholders own PFIC stock. The notice requires a PFIC to provide its shareholders with a PFIC Annual Information Statement containing information necessary to determine each shareholder's yearly income inclusion. In the case of indirect ownership of PFIC stock, a nominee or shareholder of record that has received a PFIC Annual Information Statement may issue its own statement to the shareholder containing the relevant information in lieu of passing on the PFIC Annual Information Statement.

The temporary regulations allow PFICs and intermediaries more flexibility in fulfilling these requirements. A PFIC that owns directly or indirectly any shares of one or more PFICs may provide its shareholders with a PFIC Annual Information Statement in which it combines the required information and representations of the PFIC and any lower tier PFICs. The PFIC may use any format for a combined PFIC Annual Information Statement provided the required information and representations are clearly presented and identified with the respective corporations. Similarly, an intermediary through which a shareholder indirectly holds stock in more than one PFIC may provide the shareholder a combined statement based on multiple PFIC Annual Information Statements. Comments are requested concerning alternative reporting methods that could further reduce the burden on electing shareholders.

As provided in Notice 88-125, the PFIC Annual Information Statement must include the shareholder's pro rata shares of the ordinary earnings and net capital gain of the PFIC for the PFIC's taxable year or information that will enable the shareholder to calculate its pro rata shares. In addition, the PFIC Annual Information Statement must contain information about distributions to shareholders and a statement that the PFIC will permit the shareholder to inspect and copy its permanent books of account, records, and other documents of the PFIC necessary to determine that the ordinary earnings and net capital gain of the PFIC have been calculated according to federal income tax accounting principles. Commenters indicated that it was unclear in the notice whether a shareholder, rather than the PFIC, could calculate the requisite federal income tax information with respect to a PFIC that did not keep its books and records according to U.S. tax accounting rules. In response to the comments, the temporary regulations clarify that a shareholder may obtain the books, records and other documents of the foreign corporation necessary for the shareholder to determine the correct earnings and profits and net capital gain of the PFIC according to federal income tax principles and calculate the shareholder's pro rata shares of the PFIC's ordinary earnings and net capital gain. The temporary regulations provide that, in that case, the PFIC must include a statement in its PFIC Annual Information Statement that it has permitted the shareholder to examine the PFIC's books of account, records, and other documents necessary for the shareholder to calculate the amounts of ordinary earnings and net capital gain.

Notice 88-125 provides that a domestic partnership makes the section 1295 election rather than each individual partner that is an indirect shareholder of the PFIC by reason of the partner's interest in the partnership. The notice also provides that an S corporation makes the section 1295 election. This entity-level election in the case of domestic partnerships and S corporations reflects the view that multiple elections by the partners or S corporation shareholders would be more burdensome than the single entity-level election. The temporary regulations adopt the rules of the notice with respect to elections by do-

estic pass through entities, clarifying that the section 1295 election with respect to stock owned directly or indirectly by a domestic trust or estate generally is also made at the entity level. The temporary regulations also adopt the rules of the notice with respect to interests held by foreign pass through entities. Interest holders in foreign partnerships, trusts, and estates must make the section 1295 election with respect to their indirect interests in PFICs held through those entities; foreign entities may not make the section 1295 election.

Partnerships, S corporations, trusts, and estates are referred to as pass through entities in the temporary regulations. The regulations clarify that an election made by a domestic pass through entity is made in the pass through entity's capacity as a shareholder, as specially defined in temporary regulation § 1.1295-1T(j) for purposes of the section 1295 election provisions. Thus, the domestic pass through entity takes the section 1293 inclusion into account in its return for the year in which or with which the PFIC's taxable year ends, and the interest holders in the pass through entity take the section 1293 inclusion into account under the rules applicable to inclusions of income from the pass through entity. In addition, the temporary regulations clarify that if an interest holder in a domestic pass through entity transfers stock of a PFIC subject to a section 1295 election to the pass through entity, the section 1295 election continues to apply to the interest holder whether or not the pass through entity makes the section 1295 election.

Similarly, the temporary regulations clarify the effect of the termination under section 708(b) of a partnership on a section 1295 election made by the partnership. Section 1.1295-1T(b)(3)(iii) provides that, notwithstanding the termination of a section 1295 election when a partnership terminates, the partners of the former partnership that are partners of the new partnership are bound by the section 1295 election made by the former partnership whether or not the new partnership makes a section 1295 election.

Notice 88-125 does not provide any special rules concerning tax-exempt entities. As provided in proposed regulations under section 1291 (see Regulation Project INTL-656-87, published at 1992-1

C.B. 1124), section 1291 and the regulations under section 1291 apply to a tax-exempt organization that is a shareholder of a PFIC that is not a pedigreed QEF, within the meaning of § 1.1291-9(j)(2)(ii), only if a dividend from the PFIC would be taxable to the organization under subchapter F. Section 1.1291-1T(e) of these temporary regulations provides the same rule. To prevent such a tax-exempt organization from being subject to an unnecessary section 1295 election that may have adverse consequences to the tax-exempt entity (e.g., an excise tax on gross investment income of a private foundation that arises as a consequence of a section 1295 election), the temporary regulations provide a rule that precludes a tax-exempt entity that is not taxable with respect to dividends from a PFIC from making a section 1295 election with respect to that PFIC or from being subject to a pass through entity level election.

Commenters indicated that Notice 88-125 is unclear about which taxable year of the PFIC is the first taxable year to which the section 1295 election applies. Temporary regulation § 1.1295-1T(c)(2) clarifies that the section 1295 election is effective with respect to the taxable year of the foreign corporation that ends during the shareholder's election year. Because certain shareholders may have misinterpreted Notice 88-125, the Commissioner will respect a section 1295 election made prior to February 1, 1998, that was intended to be effective for the taxable year of the PFIC that began during the shareholder's election year provided that it is clear from all the facts and circumstances that the shareholder intended the election to be effective for that taxable year of the foreign corporation. For example, a calendar year shareholder that made the section 1295 election in its 1995 return with respect to a foreign corporation whose taxable year began in 1995 and ended in 1996, with the intention that the election first apply to the foreign corporation's taxable year ended in 1996, will be treated as having made a valid section 1295 election with respect to that year.

2. Additional Clarifications.

A. Options.

Options with respect to PFIC stock present unique problems under section 1295.

Section 1297(a)(4) provides that, under regulations, an option to acquire stock may be treated as ownership of stock.

Proposed regulations under section 1291 (see Regulation Project INTL-656-87, published in 1992-1 C.B. 1124) provide that options are treated like stock for purposes of section 1291. Under proposed regulation § 1.1291-1(d), an option is considered to be stock of a PFIC that is not a pedigreed QEF for purposes of applying section 1291 to a disposition of the option, unless the holder of the actual stock which is subject to the option is currently including income from the stock under section 1293. Under proposed regulation § 1.1291-1(h)(3), the holding period of stock acquired upon exercise of an option treated as stock under § 1.1291-1(d) includes the period the option was held. These rules recognize that the value of an option is linked to the value of the underlying stock and therefore such an option should be subject to the PFIC rules.

Because of the potential for application of section 1291 to options or stock acquired upon exercise of options, some option holders have requested that regulations provide rules for making a section 1295 election with respect to an option. Application of a section 1295 election and the section 1293 current inclusion regime to options would present serious computational issues and would be administratively burdensome. Therefore, the temporary regulations continue the rule that any shareholder's section 1295 election with respect to stock of a PFIC does not apply to options to acquire stock of the PFIC and that an option holder may not make a section 1295 election with respect to the optioned stock. Accordingly, if a shareholder of stock subject to a section 1295 election exercises an option to purchase additional shares of stock of that PFIC, the stock received will be subject to the section 1295 election made by the shareholder, but, because of the rules of proposed regulation § 1.1291-1(h)(3), the stock may be treated as stock of an unpedigreed QEF.

Comments are requested concerning the option rule. In particular, comments are requested that identify any administratively feasible mechanisms that would permit a shareholder to make a section 1295 election that will apply to options.

B. Section 1295 Election Made in a Joint Return.

Section 1.1295-1T(b)(4) of the temporary regulations clarifies the application of a section 1295 election made in a joint return within the meaning of section 6013. The temporary regulations provide that a section 1295 election made in a joint return will be treated as having been made by both spouses that join in the filing of that return.

C. Lapse in PFIC Status or in Ownership.

Section 1.1295-1T(c)(2) of the temporary regulations clarifies the status of a shareholder's section 1295 election with respect to a foreign corporation after the foreign corporation ceases to be a PFIC and a QEF, or after the shareholder ceases to be a shareholder of the PFIC. In general, once a section 1295 election is made with respect to a corporation, it remains in effect, although not applicable, during those years that the foreign corporation is not a PFIC. Therefore, if the corporation requalifies as a PFIC, the section 1295 election previously made is still valid, and the shareholder is required to satisfy the requirements of that election. Furthermore, as indicated in H.R. No. 795, 100th Cong., 2d Sess., at 567 (1988), an election remains in effect with respect to a shareholder, although dormant, after a shareholder disposes of its entire interest in the PFIC. Upon the shareholder's reacquisition of an interest in the PFIC, the section 1295 election will apply to the newly acquired stock.

D. Invalidation, Termination, and Revocation of Section 1295 Elections.

As provided in temporary regulation § 1.1295-1T(i)(1), the Commissioner has discretion to invalidate or terminate a section 1295 election if the shareholder or the QEF fails to satisfy the section 1295 election requirements. However, intentional failure to satisfy the section 1295 election requirements will not automatically result in invalidation or termination. If the Commissioner invalidates a section 1295 election, the shareholder will be treated as if it never made a section 1295 election with respect to the PFIC. If the Commissioner terminates a section 1295 election for a taxable year, the section

1295 election will be valid for all taxable years before that year, but inapplicable to that year and all subsequent taxable years.

Once a shareholder makes a section 1295 election, the shareholder may revoke its section 1295 election only with the consent of the Commissioner. Temporary regulation § 1.1295-1T(i)(2) provides the rules for requesting consent to revoke an election.

The effects of an invalidation, termination, or revocation of a section 1295 election are provided in § 1.1295-1T(i)(3) of the temporary regulations. In the Commissioner's discretion, stock of a foreign corporation, with respect to which the section 1295 election is invalidated, terminated, or revoked will be treated as sold as of the last day of the PFIC's last taxable year as a QEF. The Commissioner also has the discretion to impose any other terms and conditions that the Commissioner deems necessary to ensure a shareholder's compliance with sections 1291 through 1297. In addition, revocation will terminate all section 1294 elections.

Section 1.1295-1T(i)(4) of the temporary regulations permits a shareholder to make another section 1295 election with respect to the PFIC after the fifth taxable year following the invalidation, termination, or revocation. However, the shareholder may request consent to make the section 1295 election for an earlier taxable year.

3. Section 1293.

The temporary regulations provide guidance to PFICs concerning the application of section 1(h) to section 1293 and the calculation of net capital gain. Section 1.1293-1T(a)(2) of the temporary regulations provides three alternatives for a QEF to calculate and report net capital gain. First, the PFIC may calculate and report to its shareholders the amount of each category of long-term capital gain provided in section 1(h). Alternatively, the PFIC may determine and report a single amount of net capital gain, stating that that amount of long-term capital gain is subject to the highest capital gain rate of tax applicable to the shareholder. Under the third option, the PFIC may treat the total of its earnings and profits for the taxable year as ordinary earnings. The provision of these options is intended to simplify compliance with the requirements of

sections 1293 and 1295. It is anticipated that, without providing these options, some PFICs would not be willing or able to calculate the categories of net capital gain required by section 1(h) and therefore would not provide the information necessary for a QEF shareholder to maintain a valid section 1295 election. A shareholder that has access to information necessary to calculate its pro rata share of the PFIC's ordinary earnings and net capital gain may also use any of these options. The Service requests comments about how net capital gain should be calculated, especially in light of the 1997 Act changes to section 1.

The temporary regulations under section 1293 also clarify the application of the current inclusion rules of section 1293 to interests in a QEF held through a domestic pass through entity. The temporary regulations provide generally that a U.S. person that is a shareholder of the QEF by reason of an interest in a domestic pass through entity takes into account its pro rata shares of the ordinary earnings and net capital gain of the QEF attributable to the QEF shares held by the pass through entity according to the general rules applicable to inclusions of income from the pass through entity.

4. Exempt organizations subject to section 1291.

As stated above, the temporary regulations include the rule of proposed regulation § 1.1291-1(e). Under temporary regulation § 1.1291-1T(e), if the shareholder of a PFIC is an organization exempt from tax under this chapter (including an Individual Retirement Account (IRA)), section 1291 and these regulations apply to such shareholder only if a dividend from the PFIC would be taxable to the organization under subchapter F.

5. Effective Dates of Temporary Regulations §§ 1.1291-1T(e), 1.1293-1T(a)(2), 1.1293-1T(c) and 1.1295-1T.

As stated above, Notice 88-125 provides that the notice's rules will be provided in regulations applicable to taxable years beginning after 1986. However, because the temporary regulations do not adopt the rules of Notice 88-125 in their entirety, the temporary regulations will not be retroactively applied. Therefore,

§ 1.1295-1T(c) through (j) will apply to taxable years of shareholders beginning after December 31, 1997. As provided in § 1.1295-1T(h), the Internal Revenue Service will honor taxpayer reliance on Notice 88-125 for taxable years beginning after December 31, 1986, and before January 1, 1998. Thus, if a person made a valid section 1295 election under the rules of Notice 88-125 for taxable years beginning before January 1, 1998, and, for those taxable years, complied with the rules of the notice relating to maintaining that election, the election remains in effect for taxable years beginning after December 31, 1997. However, elections made under Notice 88-125, as well as elections made under these temporary regulations, must be maintained as provided in the temporary regulations.

Temporary regulation § 1.1291-1T(e) will apply on and after April 1, 1992. Section 1.1293-1T(a)(2) of the temporary regulations will apply to sales by QEFs during their taxable years ending on or after May 7, 1997. Temporary regulation §§ 1.1293-1T(c) and 1.1295-1T(b)(2)-(iii), (b)(3), and (b)(4) will apply to taxable years of shareholders beginning after December 31, 1997.

6. Retroactive Section 1295 Elections.

a. In General.

Section 1295(b)(2) provides that, to the extent provided in regulations, a shareholder may make a section 1295 election with respect to a foreign corporation later than the election due date if the shareholder failed to make a timely section 1295 election because the shareholder reasonably believed that the foreign corporation was not a PFIC. In temporary regulation § 1.1295-3T, Treasury and the Service interpret section 1295(b)(2) to permit a shareholder of a PFIC to make a retroactive election in certain limited circumstances where the shareholder possessed reasonable belief that the corporation was not a PFIC or the shareholder demonstrates that it reasonably relied on the advice of a qualified tax professional.

As described below, the temporary regulations set forth two distinct sets of rules for making a retroactive election. Under the first set of rules, a shareholder of a PFIC that meets certain conditions may make a retroactive election without obtaining the consent of the Commissioner

(protective regime). A shareholder may make a retroactive election under the protective regime only if the shareholder possessed reasonable belief as of the election due date that the foreign corporation was not a PFIC. A shareholder of a PFIC may make a retroactive election under the protective regime even after the issue of PFIC status has been raised in an audit by the Service.

Under the second set of rules, a shareholder may make a retroactive election only after obtaining the Commissioner's consent (consent regime). To make a retroactive election under the consent regime, the shareholder must demonstrate, to the satisfaction of the Commissioner, that the shareholder's failure to make a timely section 1295 election resulted from the shareholder's reasonable reliance on the advice of a qualified tax professional. A shareholder of a PFIC may not make a retroactive election under the consent regime unless the shareholder files a request for consent before the issue of PFIC status is raised on audit.

The temporary regulations provide the exclusive rules for making a retroactive election. Thus, a shareholder that does not satisfy the requirements of the temporary regulations may not seek relief under any other provision of the law, including § 301.9100 regulations. Although such a shareholder may not make a retroactive election, the shareholder may be able to attain certain benefits associated with a retroactive election by making a section 1295 election for the current year together with a purging election under section 1291(d)(2).

b. *Protective Regime.*

A shareholder that satisfies the requirements of the protective regime may make a retroactive election under the rules of temporary regulation § 1.1295-3T(c) through (e) without obtaining the Commissioner's consent. This regime requires that the shareholder possess reasonable belief, contemporaneous with the election due date, that the foreign corporation was not a PFIC.

The legislative history of section 1295 suggests that in certain circumstances a shareholder that reasonably believed that a foreign corporation was not a PFIC for a taxable year (e.g., based on a reasonable valuation of the corporation's assets) may

make a retroactive election if the Service determines, upon examination, that the corporation was in fact a PFIC for such taxable year (e.g., based on the Service's valuation of the corporation's assets for the taxable year). Consistent with the legislative history, temporary regulation § 1.1295-3T(c) through (e) permits a shareholder to make a retroactive election for a taxable year of the shareholder (retroactive election year), even if the Service raises the PFIC status of the corporation upon audit. Although the shareholder need not request the Service's consent to make a retroactive election under this regime, the shareholder must satisfy certain conditions to make a retroactive election.

First, except for certain small shareholders, the shareholder must be able to establish that the shareholder reasonably believed, within the meaning of temporary regulation § 1.1295-3T(d), as of the election due date, that the foreign corporation was not a PFIC. Temporary regulation § 1.1295-3T(d) interprets the reasonable belief standard to require an actual determination by the shareholder, based on a good faith application of the law, that a foreign corporation was not a PFIC. Therefore, to satisfy the reasonable belief requirement, the shareholder must know and understand the PFIC provisions, and must make a good faith effort to apply the income and asset tests of section 1296 to determine whether the foreign corporation is a PFIC.

Except for certain small shareholders, a shareholder must file a single Protective Statement pursuant to temporary regulation § 1.1295-3T(c) that applies to a taxable year to preserve the shareholder's ability to make a retroactive election with respect to such taxable year of the shareholder and subsequent taxable years. The Protective Statement must contain information describing the basis for the shareholder's conclusion as of the election due date that the foreign corporation was not a PFIC for its taxable year that ended in the first taxable year of the shareholder for which the Protective Statement applies. As part of the Protective Statement, the shareholder must extend the periods of limitations for the assessment of taxes determined under sections 1291 through 1297 (PFIC related taxes) for all taxable years to which the Protective Statement

will apply, as provided in § 1.1295-3T(c)(4) of the temporary regulations. The shareholder also must include certain additional information in the Protective Statement. A special transition rule permits shareholders to use the protective regime for taxable years ending prior to January 2, 1998, provided the periods of limitations on the assessment of taxes for such years have not expired.

Temporary regulation § 1.1295-3T(e) provides special rules for certain small shareholders. A shareholder that qualifies under § 1.1295-3T(e) for a taxable year will not be required to satisfy the reasonable belief requirement or file a Protective Statement to preserve the shareholder's ability to make a retroactive election with respect to such year (a qualified shareholder).

Except as provided below, a shareholder is a qualified shareholder only if the shareholder owns, directly, indirectly or constructively, less than two percent of the vote and value of each class of stock of the foreign corporation during such year, and has not filed a Protective Statement that applies to an earlier year included in the shareholder's holding period of stock of the foreign corporation. In addition, for the special rule to apply to a taxable year of the shareholder, the foreign corporation or its U.S. counsel must have indicated in a corporate filing, shareholder mailing or similar document that the foreign corporation reasonably believed that it was not a PFIC for the taxable year of the foreign corporation that ended with or within such taxable year of the shareholder. However, no shareholder will be a qualified shareholder if the shareholder knew that the corporation was in fact a PFIC or knew or had reason to know that a corporate filing relating to the corporation's PFIC status was inaccurate. For this purpose, a shareholder will be treated as knowing that the corporation was in fact a PFIC if the principal activity of the foreign corporation is owning or trading a diversified portfolio of stock, securities, or other financial contracts. A qualified shareholder that makes a valid retroactive election in its earliest open taxable year in which the foreign corporation is a PFIC may, subject to certain conditions, be treated as a shareholder of a pedigreed QEF even if the period of limitations for the assessment of taxes for an

earlier taxable year in which the corporation qualified as a PFIC has expired.

c. Consent Regime.

Certain taxpayers have urged the Service to interpret the reasonable belief requirement of section 1295(b)(2) to allow a shareholder to make a retroactive election if the shareholder or its tax adviser did not know or properly apply the PFIC rules. In particular, certain taxpayers have recommended adoption of the reasonable action and good faith standard of § 301.9100 regulations for demonstrating reasonable belief.

Treasury and the Service recognize that the PFIC rules are complex and, in some cases, difficult for shareholders to apply. Accordingly, the temporary regulations provide that, in certain limited circumstances, a shareholder may obtain the Commissioner's consent to make a retroactive election, even if the shareholder failed to know or properly apply the PFIC rules in the earlier year. Under temporary regulation § 1.1295-3T(f), a shareholder that reasonably relied on the advice of a qualified tax professional may request consent to make a retroactive election.

In response to taxpayer comments, Treasury and the Service have incorporated into the consent regime certain rules set forth in § 301.9100 regulations. As described below, temporary regulation § 1.1295-3T(f)(1) and (4), respectively, require the shareholder to have reasonably relied on a qualified tax professional and to document such reliance. The Service will not grant consent under this regime if doing so would prejudice the interests of the government by placing the shareholder in a position more favorable than if the shareholder had made the section 1295 election on a timely basis. The temporary regulations provide that in certain cases the interests of the government may be preserved by a closing agreement between the Service and the shareholder requiring the shareholder to make a payment to the government that compensates the government for amounts that would have been due in respect of closed years affected by the retroactive election.

Under temporary regulation § 1.1295-3T(f)(2), the Service will treat a shareholder as having reasonably relied on a qualified tax professional (including an

employee of the shareholder), within the meaning of the § 301.9100 regulations, if the qualified tax professional failed to identify the corporation as a PFIC or failed to advise the shareholder of the consequences of making, or failing to make, a section 1295 election. Therefore, if a qualified tax professional, due to ignorance of the law or negligence, failed to identify the corporation as a PFIC or failed to advise the shareholder of the consequences of making, or failing to make, the section 1295 election, the Commissioner may consent to a retroactive election. However, in no event will the Commissioner consent to a retroactive election if, prior to the application for such consent, the Service has raised the PFIC status of the foreign corporation in an audit of the retroactive election year or any subsequent year. Furthermore, a shareholder may not disregard knowledge that the corporation was a PFIC or advice or knowledge relating to the tax consequences of owning stock of a PFIC and then request relief under this regime.

d. Who Makes a Retroactive Election and Who Satisfies the Requirements of the Protective or Consent Regime.

Temporary regulation § 1.1295-3T adopts the rules of temporary regulation § 1.1295-1T(d), relating to who may make a section 1295 election, for purposes of determining the appropriate person to satisfy the requirements of the protective or consent regime and to make a retroactive election. Consistent with these rules, temporary regulation § 1.1295-3T(c)(3) provides that the person that executes and files the Protective Statement under the protective regime is the person that makes the section 1295 election, as provided in § 1.1295-1T(d). Temporary regulation § 1.1295-3T(f)(4)(vi) sets forth a similar rule for requests for consent under the consent regime. In addition, temporary regulation § 1.1295-3T(g)(3) provides for an entity-level retroactive election in the case of domestic partnerships, S corporations, domestic nongrantor trusts, and domestic estates that own stock of a PFIC,

The Service welcomes comments concerning the benefits of requiring certain entities, rather than their interest holders, to satisfy the requirements under the protective and consent regimes. In particular, comments are requested concerning whether requiring S corporations, domestic nongrantor trusts, and domestic estates to satisfy the requirements of the protective regime at the entity-level is inappropriate.

e. Making a Retroactive Election.

A shareholder that has satisfied the requirements of the protective regime or has obtained the consent of the Commissioner under the consent regime must comply with the rules in temporary regulation § 1.1295-3T(g) for making a retroactive election. In general, the shareholder must file an amended return for the retroactive election year in which the shareholder complies with the requirements for making a section 1295 election, report its pro rata shares of the ordinary earnings and net capital gain of the foreign corporation for that year (section 1293 inclusion), if any, and pay any taxes resulting from the redetermination of its income and any applicable section 6621 interest. The shareholder also must file amended returns for the taxable years that follow the retroactive election year in which the foreign corporation is a PFIC and a QEF to report the section 1293 inclusion for each of these years, and pay the resulting tax and section 6621 interest. If the shareholder's taxable year in which the corporation first qualified as a PFIC, or the retroactive election year or any subsequent taxable years, are closed for the assessment of PFIC related taxes (*i.e.*, in certain cases where the shareholder is a qualified shareholder or the shareholder has obtained the consent of the Commissioner to file a retroactive election), the shareholder must file amended returns to report section 1293 inclusions in all open affected years beginning with the first taxable year open for the assessment of tax on such amounts.

7. Removal of § 1.1291-9(i)(1).

Section 1121 of the 1997 TRA amends section 1296, adding section 1296(e). Section 1296(e) provides that after December 31, 1997, a controlled foreign corporation (as defined in section 957(a))

(CFC) will not be treated as a PFIC with respect to a U.S. shareholder (as defined in section 951(b)) of the CFC. After a shareholder ceases to qualify for this exception, because the shareholder ceases to be subject to subpart F, generally the shareholder will have a new holding period for purposes of the PFIC provisions pursuant to section 1296(e)(3)(A). However, pursuant to section 1296(e)(3)(B), if the foreign corporation was a nonqualified fund before the shareholder qualified for this exception, and the shareholder did not make the section 1297(b)(1) election to purge the stock of its PFIC taint, the shareholder will not get a new holding period when it ceases to qualify for the exception for U.S. shareholders of CFCs. Congress, in the Conference Report to the 1997 TRA, H.R. Rept. 105-220, 105th Congress, 1st session, at 625, stated that “the stock held by such shareholder continues to be treated as PFIC stock unless the shareholder makes an election to pay tax and an interest charge with respect to the unrealized appreciation in the stock or the accumulated earnings of the corporation.” Congress thus indicated its intent that a shareholder may apply the rules of either section 1291(d)(2)(A), the deemed sale election, or section 1291(d)(2)(B), the deemed dividend election, when making the section 1297(b)(1) election to purge a former PFIC of its PFIC taint. In order to give effect to that intent, Treasury and the IRS have decided to remove § 1.1291-9(i)(1), which provides that the rules of § 1.1291-9, the deemed dividend election, do not apply to an election under section 1297(b)(1). The removal of § 1.1291-9(i)(1) is effective as of January 2, 1998. Section 1.1291-9(i)(2) is not affected by the removal of § 1.1291-9(i)(1).

8. *Section 1297.*

The temporary regulations amend § 1.1297-3T to provide that a shareholder of a former PFIC, within the meaning of § 1.1291-9(j)(2)(iv), that was a CFC during its last taxable year as a PFIC under section 1296(a), may apply the rules of the deemed dividend election under section 1291(d)(2)(B) and § 1.1291-9 to its section 1297(b)(1) election made by the time and in the manner provided in § 1.1297-3T(b). If the time for making a section 1297(b)(1) election, provided in § 1.1297-3T(b), expired before January

2, 1998, a shareholder that applied the rules of section 1291(d)(2)(A) and § 1.1291-10 to a section 1297(b)(1) election, made with respect to a former PFIC that was a CFC in its last taxable year as a PFIC under section 1296(a), may file an amended return for its taxable year that includes the termination date, as defined in § 1.1297-3T(a), and apply the rules of the deemed dividend election to its section 1297(b)(1) election at any time before the expiration of the period of limitations for the assessment of taxes for that taxable year. Section 1.1297-3T(c) is effective as of January 2, 1998.

Special Analyses

It has been determined that this Treasury Decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business. An initial regulatory flexibility analysis has been prepared for the proposed regulations for which these temporary regulations serve as a text and which is set forth in REG-115795-97.

Drafting Information

The principal authors of these regulations are Gayle Novig and Judith Cavell Cohen, of the Office of the Associate Chief Counsel (International). Other personnel from the IRS and Treasury Department also participated in the development of these regulations.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding the following entries, in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1291-1T also issued under 26 U.S.C. 1291.* * *

Section 1.1293-1T also issued under 26 U.S.C. 1293.* * *

Section 1.1295-1T also issued under 26 U.S.C. 1295(b).

Section 1.1295-3T also issued under 26 U.S.C. 1295(b).* * *

§ 1.1291-0 [Amended]

Par. 2. Section 1.1291-0 is amended by removing and reserving the entry for § 1.1291-9(i)(1).

Par. 3. The section heading and introductory text for § 1.1294-0 are added to read as follows:

§ 1.1294-0 Table of contents.

This section contains a listing of the headings for § 1.1294-1T.

Par. 4. The section heading and introductory text for § 1.1297-0 are added to read as follows:

§ 1.1297-0 Table of contents.

This section contains a listing of the headings for § 1.1297-3T.

§ 1.1291-0T [Amended]

Par. 5. Section 1.1291-0T is amended by:

1. Transferring the listing of the section heading and entries for § 1.1294-1T to new § 1.1294-0.
2. Transferring the listing of the section heading and entries for § 1.1297-3T to new § 1.1297-0.
3. Removing the section heading and introductory text.

Par. 6. Section 1.1291-1T is added to read as follows.

§ 1.1291-1T Taxation of U.S. persons that are shareholders of PFICs that are not pedigreed QEFs (temporary).

(a) through (d) [Reserved].

(e) *Exempt organization as shareholder—(1) In general.* If the shareholder of a PFIC is an organization exempt from tax under this chapter, section 1291 and these regulations apply to such shareholder only if a dividend from the PFIC would be taxable to the organization under subchapter F.

(2) *Effective date.* Paragraph (e)(1) of this section is applicable on and after April 1, 1992.

§ 1.1291-9 [Amended]

Par. 7. Section 1.1291-9 is amended by removing and reserving paragraph (i)(1).

Par. 8. Section 1.1293-0 is added to read as follows.

§ 1.1293-0 Table of contents.

This section contains a listing of the headings for § 1.1293-1T.

§ 1.1293-1T Current inclusion of income of qualified electing funds (temporary).

- (a) In general. [Reserved].
- (1) Other rules. [Reserved].
- (2) Net capital gain defined.
 - (i) In general.
 - (ii) Effective date.
- (b) Other rules. [Reserved].
- (c) Application of rules of inclusion with respect to stock held by a pass through entity.
 - (1) In general.
 - (2) QEF stock transferred to a pass through entity.
 - (i) Pass through entity makes a section 1295 election.
 - (ii) Pass through entity does not make a section 1295 election.
 - (3) Effective date.

Par. 9. Section 1.1293-1T is added to read as follows:

§ 1.1293-1T Current taxation of income from qualified electing funds (temporary).

- (a) In general. [Reserved].
- (1) Other rules. [Reserved].
- (2) Net capital gain defined—(i) In general. This paragraph (a)(2) defines the term net capital gain for purposes of sections 1293 and 1295 and the regulations under those sections. The QEF, as defined in § 1.1291-9(j)(2)(i), in determining its net capital gain for a taxable year, may either—
 - (A) Calculate and report the amount of each category of long-term capital gain provided in section 1(h) that was recognized by the PFIC in the taxable year;
 - (B) Calculate and report the amount of net capital gain recognized by the PFIC in the taxable year, stating that that amount is subject to the highest capital gain rate of tax applicable to the shareholder; or
 - (C) Calculate its earnings and profits for the taxable year and report the entire amount as ordinary earnings.

(ii) *Effective date.* Paragraph (a)(2)(i) of this section is applicable to sales by QEFs during their taxable years ending on or after May 7, 1997.

(b) *Other rules.* [Reserved].

(c) *Application of rules of inclusion with respect to stock held by a pass through entity*—(1) *In general.* A domestic pass through entity takes into account its pro rata shares of the ordinary earnings and net capital gain attributable to the QEF shares held by the pass through entity. A U.S. person that indirectly owns QEF shares through the domestic pass through entity accounts for its pro rata shares of ordinary earnings and net capital gain attributable to the QEF shares according to the general rules applicable to inclusions of income from the domestic pass through entity. For the definition of pass through entity, see § 1.1295-1T(j).

(2) *QEF stock transferred to a pass through entity*—(i) *Pass through entity makes a section 1295 election.* If a shareholder transfers stock subject to a section 1295 election to a domestic pass through entity of which it is an interest holder and the pass through entity makes a section 1295 election with respect to that stock, as provided in § 1.1295-1T(d)(2), the shareholder takes into account its pro rata shares of the ordinary earnings and net capital gain attributable to the QEF shares under the rules applicable to inclusions of income from the pass through entity.

(ii) *Pass through entity does not make a section 1295 election.* If the pass through entity does not make a section 1295 election with respect to the PFIC, the shares of which were transferred to the pass through entity subject to the 1295 election of the shareholder, the shareholder continues to be subject, in its capacity as an indirect shareholder, to the income inclusion rules of section 1293 and reporting rules required of shareholders of QEFs. Proper adjustments to reflect an inclusion in income under section 1293 by the indirect shareholder must be made, under the principles of § 1.1291-9(f), to the basis of the indirect shareholder's interest in the pass through entity.

(3) *Effective date.* Paragraph (c) of this section is applicable to taxable years of shareholders beginning after December 31, 1997.

Par. 10. Section 1.1295-0 is added to read as follows:

§ 1.1295-0 Table of contents.

This section contains a listing of the headings for §§ 1.1295-1T and 1.1295-3T.

§ 1.1295-1T Qualified electing funds (temporary).

- (a) In general. [Reserved].
- (b) Application of section 1295 election. [Reserved].
 - (1) Election personal to shareholder. [Reserved].
 - (2) Election applicable to specific corporation only.
 - (i) In general. [Reserved].
 - (ii) Stock of QEF received in a non-recognition transfer. [Reserved].
 - (iii) Exception for options.
 - (3) Application of general rules to stock held by a pass through entity.
 - (i) Stock subject to a section 1295 election transferred to a pass through entity.
 - (ii) Limitation on application of pass through entity's section 1295 election.
 - (iii) Effect of partnership termination on section 1295 election.
 - (iv) Characterization of stock held through a pass through entity.
 - (4) Application of general rules to a taxpayer filing a joint return under section 6013.
- (c) Effect of section 1295 election.
 - (1) In general.
 - (2) Years to which section 1295 election applies.
 - (i) In general.
 - (ii) Effect of PFIC status on election.
 - (iii) Effect on election of complete termination of a shareholder's interest in the PFIC.
 - (iv) Effect on section 1295 election of transfer of stock to a domestic pass through entity.
 - (v) Examples.
- (d) Who may make a section 1295 election.
 - (1) General rule.
 - (2) Application of general rule to pass through entities.
 - (i) Partnerships.
 - (A) Domestic partnership.
 - (B) Foreign partnership.
 - (ii) S corporation.
 - (iii) Trust or estate.

- (A) Domestic trust or estate.
 - (I) Nongrantor trust or estate.
- (2) Grantor trust.
- (B) Foreign trust or estate.
 - (I) Nongrantor trust or estate.
 - (2) Grantor trust.
- (iv) Indirect ownership of the pass through entity or the PFIC.
- (3) Member of consolidated return group as shareholder.
- (4) Option holder.
- (5) Exempt organization.
- (e) Time for making a section 1295 election.
- (f) Manner of making a section 1295 election and the annual election requirements of the shareholder.
 - (1) Manner of making the election.
 - (2) Annual election requirements.
 - (i) In general.
 - (ii) Retention of documents.
 - (g) Annual election requirements of the PFIC or intermediary.
 - (1) PFIC Annual Information Statement.
 - (2) Alternative documentation.
 - (3) Annual Intermediary Statement.
 - (4) Combined statements.
 - (i) PFIC Annual Information Statement.
 - (ii) Annual Intermediary Statement.
 - (h) Transition rules.
 - (i) Invalidation, termination or revocation of section 1295 election.
 - (1) Invalidation or termination of election at the discretion of the Commissioner.
 - (i) In general.
 - (ii) Deferral of section 1293 inclusion.
 - (iii) When effective.
 - (2) Shareholder revocation.
 - (i) In general.
 - (ii) Time for and manner of requesting consent to revoke.
 - (A) Time.
 - (B) Manner of making request.
 - (iii) When effective.
 - (3) Effect of invalidation, termination, or revocation.
 - (4) Election after invalidation, termination, or revocation.
 - (j) Definitions.
 - (k) Effective date.

§ 1.1295-3T Retroactive elections (temporary).

- (a) In general.

- (b) General rule.
 - (c) Protective Statement.
 - (1) In general.
 - (2) Reasonable belief statement.
 - (3) Who executes and files the Protective Statement.
 - (4) Waiver of the periods of limitations.
 - (i) Time for and manner of extending periods of limitations.
 - (A) In general.
 - (B) Application of general rule to domestic partnerships.
 - (I) In general.
 - (2) Special rules.
 - (i) Addition of partner to non-TEFRA partnership.
 - (ii) Change in status from non-TEFRA partnership to TEFRA partnership.
 - (C) Application of general rule to domestic nongrantor trusts and domestic estates.
 - (D) Application of general rule to S corporations.
 - (E) Effect on waiver of complete termination of a pass through entity or pass through entity's business.
 - (F) Application of general rule to foreign partnerships, foreign trusts, domestic or foreign grantor trusts, and foreign estates.
 - (ii) Terms of waiver.
 - (A) Scope of waiver.
 - (B) Period of waiver.
 - (5) Time for and manner of filing a Protective Statement.
 - (i) In general.
 - (ii) Special rule for taxable years ended before January 2, 1998.
 - (6) Applicability of the Protective Statement.
 - (i) In general.
 - (ii) Invalidity of the Protective Statement.
 - (7) Retention of Protective Statement and information demonstrating reasonable belief.
 - (d) Reasonable belief.
 - (1) In general.
 - (2) Knowledge of law required.
 - (e) Special rules for qualified shareholders.
 - (1) In general.
 - (2) Qualified shareholder.
 - (3) Exceptions.
 - (f) Special consent.
 - (1) In general.

- (2) Reasonable reliance on a qualified tax professional.
 - (i) In general.
 - (ii) Shareholder deemed to have not reasonably relied on a qualified tax professional.
- (3) Prejudice to the interests of the United States government.
 - (i) General rule.
 - (ii) Elimination of prejudice to the interests of the United States government.
 - (4) Procedural requirements.
 - (i) Filing instructions.
 - (ii) Affidavit from shareholder.
 - (iii) Affidavits from other persons.
 - (iv) Other information.
 - (v) Notification of Internal Revenue Service.
 - (vi) Who requests special consent under this paragraph (f) and who enters into a closing agreement.
 - (g) Time for and manner of making a retroactive election.
 - (1) Time for making a retroactive election.
 - (i) In general.
 - (ii) Transition rule.
 - (iii) Ownership not required at time retroactive election is made.
 - (2) Manner of making a retroactive election.
 - (3) Who makes the retroactive election.
 - (4) Other elections.
 - (i) Section 1291(d)(2) election.
 - (ii) Section 1294 election.
 - (h) Effective date.

Par. 11. Section 1.1295-1T is added to read as follows:

§ 1.1295-1T Qualified electing funds (temporary).

- (a) *In general.* [Reserved].
- (b) *Application of section 1295 election.* [Reserved].
 - (1) *Election personal to shareholder.* [Reserved].
 - (2) *Election applicable to specific corporation only—*
 - (i) *In general.* [Reserved].
 - (ii) *Stock of QEF received in a non-recognition transfer.* [Reserved].
 - (iii) *Exception for options.* A shareholder's section 1295 election does not apply to any option to buy stock of the PFIC.
 - (3) *Application of general rules to stock held by a pass through entity—(i)*

Stock subject to a section 1295 election transferred to a pass through entity. A shareholder's section 1295 election will not apply to a domestic pass through entity to which the shareholder transfers stock subject to a section 1295 election, or to any other U.S. person that is an interest holder or beneficiary of the domestic pass through entity. However, as provided in paragraph (c)(2)(iv) of this section (relating to a transfer to a domestic pass through entity of stock subject to a section 1295 election), a shareholder that transfers stock subject to a section 1295 election to a pass through entity will continue to be subject to the section 1295 election with respect to the stock indirectly owned through the pass through entity and any other stock of that PFIC owned by the shareholder.

(ii) *Limitation on application of pass through entity's section 1295 election.* Except as provided in paragraph (c)(2)(iv) of this section, a section 1295 election made by a domestic pass through entity does not apply to other stock of the PFIC held directly or indirectly by the interest holder or beneficiary.

(iii) *Effect of partnership termination on section 1295 election.* Termination of a section 1295 election made by a domestic partnership by reason of the termination of the partnership under section 708(b) will not terminate the section 1295 election with respect to partners of the terminated partnership that are partners of the new partnership. Except as otherwise provided, the stock of the PFIC of which the new partners are indirect shareholders will be treated as stock of a QEF only if the new domestic partnership makes a section 1295 election with respect to that stock.

(iv) *Characterization of stock held through a pass through entity.* Stock of a PFIC held through a pass through entity will be treated as stock of a pedigreed QEF with respect to an interest holder or beneficiary only if—

(A) In the case of PFIC stock acquired (other than in a transaction in which gain is not recognized pursuant to regulations under section 1291(f) with respect to that stock), and held by a domestic pass through entity, the pass through entity makes the section 1295 election and the PFIC has been a QEF with respect to the pass through entity for all taxable years

that are included wholly or partly in the pass through entity's holding period of the PFIC stock and during which the foreign corporation was a PFIC within the meaning of § 1.1291-9(j)(1); or

(B) In the case of PFIC stock transferred by an interest holder or beneficiary to a pass through entity in a transaction in which gain is not recognized pursuant to regulations under section 1291(f) with respect to that stock and held by the pass through entity, the PFIC stock transferred to the pass through entity was treated as stock of a pedigreed QEF with respect to the interest holder or beneficiary at the time of the transfer and the pass through entity makes a section 1295 election.

(4) *Application of general rules to a taxpayer filing a joint return under section 6013.* A section 1295 election made by a taxpayer in a joint return, within the meaning of section 6013, will be treated as also made by the spouse that joins in the filing of that return.

(c) *Effect of section 1295 election—(1) In general.* Except as otherwise provided in this paragraph (c), the effect of a shareholder's section 1295 election is to treat the foreign corporation as a QEF with respect to the shareholder for each taxable year of the foreign corporation ending with or within a taxable year of the shareholder for which the election is effective. A section 1295 election is effective for the shareholder's election year and all subsequent taxable years of the shareholder unless invalidated, terminated or revoked as provided in paragraph (i) of this section. The terms shareholder and shareholder's election year are defined in paragraph (j) of this section.

(2) *Years to which section 1295 election applies—(i) In general.* Except as otherwise provided in this paragraph (c), a foreign corporation with respect to which a section 1295 election is made will be treated as a QEF for its taxable year ending with or within the shareholder's election year and all subsequent taxable years of the foreign corporation that are included wholly or partly in the shareholder's holding period (or periods) of stock of the foreign corporation.

(ii) *Effect of PFIC status on election.* A foreign corporation will not be treated as a QEF for any taxable year of the foreign corporation that the foreign corpora-

tion is not a PFIC under section 1296(a) and is not treated as a PFIC under section 1297(b)(1). However, cessation of a foreign corporation's status as a PFIC will not terminate a section 1295 election.

(iii) *Effect on election of complete termination of a shareholder's interest in the PFIC.* Complete termination of a shareholder's direct and indirect interest in stock of a foreign corporation will not terminate a shareholder's section 1295 election with respect to the foreign corporation.

(iv) *Effect on section 1295 election of transfer of stock to a domestic pass through entity.* The transfer of a shareholder's direct or indirect interest in stock of a foreign corporation to a domestic pass through entity (as defined in paragraph (j) of this section) will not terminate the shareholder's section 1295 election with respect to the foreign corporation, whether or not the pass through entity makes a section 1295 election. For the rules concerning the application of section 1293 to stock transferred to a domestic pass through entity, see § 1.1293-1T(c).

(v) *Examples.* The following examples illustrate the rules of this paragraph (c)(2).

Example 1. In 1998, C, a U.S. person, purchased stock of FC, a foreign corporation that is a PFIC. Both FC and C are calendar year taxpayers. C made a timely section 1295 election to treat FC as a QEF in C's 1998 return, and FC was therefore a pedigreed QEF. C included its shares of FC's 1998 ordinary earnings and net capital gain in C's 1998 income and did not make a section 1294 election to defer the time for payment of tax on that income. In 1999, 2000, and 2001, FC did not satisfy either the income or asset test of section 1296(a), and therefore was neither a PFIC nor a QEF. C therefore did not have to include its pro rata shares of the ordinary earnings and net capital gain of FC pursuant to section 1293, or satisfy the section 1295 annual reporting requirements for any of those years. FC qualified as a PFIC again in 2002. Because C had made a section 1295 election in 1998, and the election had not been invalidated, terminated, or revoked, within the meaning of paragraph (i) of this section, C's section 1295 election remains in effect for 2002. C therefore is subject in 2002 to the income inclusion and reporting rules required of shareholders of QEFs.

Example 2. The facts are the same as in Example (1) except that FC did not lose PFIC status in any year and C sold all the FC stock in 1999 and repurchased stock of FC in 2002. Because C had made a section 1295 election in 1998 with respect to stock of FC, and the election had not been invalidated, terminated, or revoked, within the meaning of paragraph (i) of this section, C's section 1295 election remained in effect and therefore applies to the stock

of FC purchased by C in 2002. C therefore is subject in 2002 to the income inclusion and reporting rules required of shareholders of QEFs.

Example 3. The facts are the same as in Example (2) except that C is a partner in domestic partnership P and C transferred its FC stock to P in 1999. Because C had made a section 1295 election in 1998 with respect to stock of FC, and the election had not been invalidated, terminated, or revoked, within the meaning of paragraph (i) of this section, C's section 1295 election remains in effect with respect to its indirect interest in the stock of FC. If P does not make the section 1295 election with respect to the FC stock, C will continue to be subject, in C's capacity as an indirect shareholder of FC, to the income inclusion and reporting rules required of shareholders of QEFs in 1999 and subsequent years. If P makes the section 1295 election, C will take into account its pro rata shares of the ordinary earnings and net capital gain of the FC under the rules applicable to inclusions of income from P.

(d) *Who may make a section 1295 election*—(1) *General rule.* Except as otherwise provided in this paragraph (d), any U.S. person that is a shareholder (as defined in paragraph (j) of this section) of a PFIC, including a shareholder that holds stock of a PFIC in bearer form, may make a section 1295 election with respect to that PFIC. The shareholder need not own directly or indirectly any stock of the PFIC at the time the shareholder makes the section 1295 election provided the shareholder is a shareholder of the PFIC during the taxable year of the PFIC that ends with or within the taxable year of the shareholder for which the section 1295 election is made. Except in the case of a shareholder that is an exempt organization that may not make a section 1295 election, as provided in paragraph (d)(5) of this section, in a chain of ownership only the first U.S. person that is a shareholder of the PFIC may make the section 1295 election.

(2) *Application of general rule to pass through entities*—(i) *Partnerships*—(A) *Domestic partnership.* A domestic partnership that holds an interest in stock of a PFIC makes the section 1295 election with respect to that PFIC. The partnership election applies only to the stock of the PFIC held directly or indirectly by the partnership and not to any other stock held directly or indirectly by any partner. As provided in § 1.1293-1T(c)(1), shareholders owning stock of a QEF by reason of an interest in the 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.

(B) *Foreign partnership.* A U.S. person that holds an interest in a foreign partnership that, in turn, holds an interest in stock of a PFIC makes the section 1295 election with respect to that PFIC. A partner's election applies to the stock of the PFIC owned directly or indirectly by the foreign partnership and to any other stock of the PFIC owned by that partner. A section 1295 election by a partner applies only to that partner.

(ii) *S corporation.* An S corporation that holds an interest in stock of a PFIC makes the section 1295 election with respect to that PFIC. The S corporation election applies only to the stock of the PFIC held directly or indirectly by the S corporation and not to any other stock held directly or indirectly by any S corporation shareholder. As provided in § 1.1293-1T(c)(1), shareholders owning stock of a QEF by reason of an interest in the S corporation take into account the section 1293 inclusions with respect to the QEF shares under the rules applicable to inclusions of income from the S corporation.

(iii) *Trust or estate*—(A) *Domestic trust or estate*—(1) *Nongrantor trust or estate.* A domestic nongrantor trust or a domestic estate that holds an interest in stock of a PFIC makes the section 1295 election with respect to that PFIC. The trust or estate's election applies only to the stock of the PFIC held directly or indirectly by the trust or estate and not to any other stock held directly or indirectly by any beneficiary. As provided in § 1.1293-1T(c)(1), shareholders owning stock of a QEF by reason of an interest in a domestic trust or estate take into account the section 1293 inclusions with respect to the QEF shares under the rules applicable to inclusions of income from the trust or estate.

(2) *Grantor trust.* A U.S. person that is treated under sections 671 through 678 as the owner of the portion of a domestic trust that owns an interest in stock of a PFIC makes the section 1295 election with respect to that PFIC. If that person ceases to be treated as the owner of the portion of the trust that owns an interest in the PFIC stock and is a beneficiary of the trust, that person's section 1295 election will continue to apply to the PFIC stock indirectly owned by that person under the

rules of paragraph (c)(2)(iv) of this section as if the person had transferred its interest in the PFIC stock to the trust. However, the stock will be treated as stock of a PFIC that is not a QEF with respect to other beneficiaries of the trust, unless the trust makes the section 1295 election as provided in paragraph (d)(2)(iii)(A)(1) of this section.

(B) *Foreign trust or estate*—(1) *Nongrantor trust or estate.* A U.S. person that is a beneficiary of a foreign nongrantor trust or estate that holds an interest in stock of a PFIC makes the section 1295 election with respect to that PFIC. A beneficiary's section 1295 election applies to all the PFIC stock owned directly and indirectly by the trust or estate and to the other PFIC stock owned directly or indirectly by the beneficiary. A section 1295 election by a beneficiary applies only to that beneficiary.

(2) *Grantor trust.* A U.S. person that is treated under sections 671 through 679 as the owner of the portion of a foreign trust that owns an interest in stock of a PFIC makes the section 1295 election with respect to that PFIC. If that person ceases to be treated as the owner of the portion of the trust that owns an interest in the PFIC stock and is a beneficiary of the trust, that person's section 1295 election will continue to apply to the PFIC stock indirectly owned by that person under the rules of paragraph (c)(2)(iv) of this section. However, as provided in paragraph (d)(2)(iii)(B)(1) of this section, any other shareholder that is a beneficiary of the trust and that wishes to treat the PFIC as a QEF must make the section 1295 election.

(iv) *Indirect ownership of the pass through entity or the PFIC.* The rules of this paragraph (d)(2) apply whether or not the shareholder holds its interest in the pass through entity directly or indirectly and whether or not the pass through entity holds its interest in the PFIC directly or indirectly.

(3) *Member of consolidated return group as shareholder.* Pursuant to § 1.1502-77(a), the common parent of an affiliated group of corporations that join in filing a consolidated income tax return makes a section 1295 election for all members of the affiliated group. An election by a common parent will be effective for all members of the affiliated group with respect to interests in PFIC stock

held at the time the election is made or at any time thereafter. A separate election must be made by the common parent for each PFIC of which a member of the affiliated group is a shareholder.

(4) *Option holder.* A holder of an option to acquire stock of a PFIC may not make a section 1295 election that will apply to the option or to the stock subject to the option.

(5) *Exempt organization.* A tax-exempt organization that is not taxable under section 1291, pursuant to § 1.1291-1T(e), with respect to a PFIC may not make a section 1295 election with respect to that PFIC. In addition, such an exempt organization will not be subject to any section 1295 election made by a domestic pass through entity.

(e) *Time for making a section 1295 election.* Except as provided in § 1.1295-3T, a shareholder making the section 1295 election must make the election on or before the due date, as extended under section 6081 (election due date), for filing the shareholder's income tax return for the first taxable year to which the election will apply. The section 1295 election must be made in the original return for that year, or in an amended return, provided the amended return is filed on or before the election due date.

(f) *Manner of making a section 1295 election and the annual election requirements of the shareholder—(1) Manner of making the election.* A shareholder must make a section 1295 election by—

(i) Completing Form 8621 in the manner required by that form and this section for making the section 1295 election;

(ii) Attaching Form 8621 to its federal income tax return filed by the election due date for the shareholder's election year;

(iii) Receiving and reflecting in Form 8621 the information provided in the PFIC Annual Information Statement described in paragraph (g)(1) of this section, the Annual Intermediary Statement described in paragraph (g)(3) of this section, or the applicable combined statement described in paragraph (g)(4) of this section, for the taxable year of the PFIC ending with or within the taxable year for which Form 8621 is being filed. If the PFIC Annual Information Statement contains a statement described in paragraph (g)(1)(ii)(C) of this section, the shareholder must attach a statement to Form

8621 that indicates that the shareholder rather than the QEF calculated the QEF's ordinary earnings and net capital gain; and

(iv) Filing a copy of Form 8621 with the Philadelphia Service Center, P.O. 21086, Philadelphia, PA 19114 by the election due date.

(2) *Annual election requirements—(i) In general.* A shareholder that makes a section 1295 election with respect to a PFIC held directly or indirectly, for each taxable year to which the section 1295 election applies, must—

(A) Complete Form 8621 in the manner required by that form and this section;

(B) Attach Form 8621 to its federal income tax return filed by the due date of the return, as extended;

(C) Receive and reflect in Form 8621 the PFIC Annual Information Statement described in paragraph (g)(1) of this section, the Annual Intermediary Statement described in paragraph (g)(3) of this section, or the applicable combined statement described in paragraph (g)(4) of this section, for the taxable year of the PFIC ending with or within the taxable year for which Form 8621 is being filed. If the PFIC Annual Information Statement contains a statement described in paragraph (g)(1)(ii)(C) of this section, the shareholder must attach a statement to its Form 8621 that the shareholder rather than the PFIC provided the calculations of the PFIC's ordinary earnings and net capital gain; and

(D) File a copy of Form 8621 with the Philadelphia Service Center, P.O. 21086, Philadelphia, PA 19114 by the election due date.

(ii) *Retention of documents.* For all taxable years subject to the section 1295 election, the shareholder must retain copies of all Forms 8621, with their attachments, and PFIC Annual Information Statements or Annual Intermediary Statements. Failure to produce those documents at the request of the Commissioner in connection with an examination may result in invalidation or termination of the shareholder's section 1295 election.

(g) *Annual election requirements of the PFIC or intermediary—(1) PFIC Annual Information Statement.* For each year of the PFIC ending in a taxable year of a shareholder to which the shareholder's section 1295 election applies, the PFIC

must provide the shareholder with a PFIC Annual Information Statement. The PFIC Annual Information Statement is a statement of the PFIC, signed by the PFIC or an authorized representative of the PFIC, that contains the following information and representation—

(i) The first and last days of the taxable year of the PFIC to which the PFIC Annual Information Statement applies;

(ii) Either—

(A) The shareholder's pro rata shares of the ordinary earnings and net capital gain (as defined in § 1.1293-1T(a)(2)) of the PFIC for the taxable year indicated in paragraph (g)(1)(i) of this section; or

(B) Sufficient information to enable the shareholder to calculate its pro rata shares of the PFIC's ordinary earnings and net capital gain, for that taxable year; or

(C) A statement that the foreign corporation has permitted the shareholder to examine the books of account, records, and other documents of the foreign corporation for the shareholder to calculate the amounts of the PFIC's ordinary earnings and the net capital gain according to federal income tax accounting principles and to calculate the shareholder's pro rata shares of the PFIC's ordinary earnings and net capital gain;

(iii) The amount of cash and the fair market value of other property distributed or deemed distributed to the shareholder during the taxable year of the PFIC to which the PFIC Annual Information Statement pertains; and

(iv) Either—

(A) A statement that the PFIC will permit the shareholder to inspect and copy the PFIC's permanent books of account, records, and such other documents as may be maintained by the PFIC to establish that the PFIC's ordinary earnings and net capital gain are computed in accordance with U.S. income tax principles, and to verify these amounts and the shareholder's pro rata shares thereof; or

(B) In lieu of the statement required in paragraph (g)(1)(iv)(A) of this section, a description of the alternative documentation requirements approved by the Commissioner, with a copy of the private letter ruling and the closing agreement entered into by the Commissioner and the PFIC pursuant to paragraph (g)(2) of this section.

(2) *Alternative documentation.* In rare and unusual circumstances, the Commis-

sioner will consider alternative documentation requirements necessary to verify the ordinary earnings and net capital gain of a PFIC other than the documentation requirements described in paragraph (g)(1)(iv)(A) of this section. Alternative documentation requirements will be allowed only pursuant to a private letter ruling and a closing agreement entered into by the Commissioner and the PFIC describing an alternative method of verifying the PFIC's ordinary earnings and net capital gain. If the PFIC has not obtained a private letter ruling from the Commissioner approving an alternative method of verifying the PFIC's ordinary earnings and net capital gain by the time a shareholder is required to make a section 1295 election, the shareholder may not use an alternative method for that taxable year.

(3) *Annual Intermediary Statement.* In the case of a U.S. person that is a shareholder of a PFIC through an intermediary, as defined in paragraph (j) of this section, an Annual Intermediary Statement issued by an intermediary containing the information described in paragraph (g)(1) of this section and reporting the indirect owner's pro rata shares of the ordinary earnings and net capital gain of the QEF as described in paragraph (g)(1)(ii)(A) of this section, may be provided to the indirect owner in lieu of the PFIC Annual Information Statement if the following conditions are satisfied—

(i) The intermediary receives a copy of the PFIC Annual Information Statement or the intermediary receives an annual intermediary statement from another intermediary which contains a statement that the other intermediary has received a copy of the PFIC Annual Information Statement and represents that the conditions of paragraphs (g)(3)(ii) and (g)(3)(iii) of this section are met;

(ii) The representations and information contained in the Annual Intermediary Statement reflect the representations and information contained in the PFIC Annual Information Statement; and

(iii) The PFIC Annual Information Statement issued to the intermediary contains either the representation set forth in paragraph (g)(1)(iv)(A) of this section, or, if alternative documentation requirements were approved by the Commissioner pursuant to paragraph (g)(2) of this section, a copy of the private letter ruling and clos-

ing agreement between the Commissioner and the PFIC, agreeing to an alternative method of verifying PFIC ordinary earnings and net capital gain as described in paragraph (g)(2) of this section;

(4) *Combined statements*—(i) *PFIC Annual Information Statement.* A PFIC that owns directly or indirectly any stock of one or more PFICs with respect to which a shareholder may make the section 1295 election may prepare a PFIC Annual Information Statement that combines with its own information and representations the information and representations of all the PFICs. The PFIC may use any format for a combined PFIC Annual Information Statement provided the required information and representations are separately stated and identified with the respective corporations.

(ii) *Annual Intermediary Statement.* An intermediary described in paragraph (g)(3) of this section that owns directly or indirectly stock of one or more PFICs with respect to which an indirect shareholder may make the section 1295 election may prepare an Annual Intermediary Statement that combines with its own information and representations the information and representations with respect to all the PFICs. The intermediary may use any format for a combined Annual Intermediary Statement provided the required information and representations are separately stated and identified with the intermediary and the respective corporations.

(h) *Transition rules.* The rules of Notice 88-125, 1988-2 C.B. 535 (see § 601.601(d)(2)(ii)(b) of this chapter), apply for making elections and maintaining elections for taxable years beginning after December 31, 1986, and before January 1, 1998. Elections made under Notice 88-125 must be maintained as provided in § 1.1295-1T for taxable years beginning after December 31, 1997. A section 1295 election made prior to February 1, 1998, that was intended to be effective for the taxable year of the PFIC that began during the shareholder's election year will be effective for that taxable year of the foreign corporation provided that it is clear from all the facts and circumstances that the shareholder intended the election to be effective for that taxable year of the foreign corporation.

(i) *Invalidation, termination, or revocation of section 1295 election*—(1) *In-*

validation or termination of election at the discretion of the Commissioner—(i) *In general.* The Commissioner, in the Commissioner's discretion, may invalidate or terminate a section 1295 election applicable to a shareholder if the shareholder, the PFIC, or any intermediary fails to satisfy the requirements for making a section 1295 election or the annual election requirements of this section to which the shareholder, PFIC, or intermediary is subject, including the requirement to provide, on request, copies of the books and records of the PFIC or other documentation substantiating the ordinary earnings and net capital gain of the PFIC.

(ii) *Deferral of section 1293 inclusion.* The Commissioner may invalidate any pass through entity section 1295 election with respect to an interest holder or beneficiary if the section 1293 inclusion with respect to that interest holder or beneficiary is not included in the gross income of either the pass through entity, an intermediate pass through entity, or the interest holder or beneficiary within two years of the end of the PFIC's taxable year due to nonconforming taxable years of the interest holder and the pass through entity or any intermediate pass through entity.

(ii) *When effective.* Termination of a shareholder's section 1295 election will be effective for the taxable year of the PFIC determined by the Commissioner in the Commissioner's discretion. An invalidation of a shareholder's section 1295 election will be effective for the first taxable year to which the section 1295 election applied, and the shareholder whose election is invalidated will be treated as if the section 1295 election never was made.

(2) *Shareholder revocation*—(i) *In general.* In the Commissioner's discretion, upon a finding of a substantial change in circumstances, the Commissioner may consent to a shareholder's request to revoke a section 1295 election. Request for revocation must be made by the shareholder that made the election and at the time and in the manner provided in paragraph (i)(2)(ii) of this section.

(ii) *Time for and manner of requesting consent to revoke*—(A) *Time.* The shareholder must request consent to revoke the section 1295 election no later than 12 calendar months after the discovery of the substantial change of circumstances that

forms the basis for the shareholder's request to revoke the section 1295 election.

(B) *Manner of making request.* A shareholder requests consent to revoke a section 1295 election by filing a ruling request with the Office of the Associate Chief Counsel (International). The ruling request must satisfy the requirements, including payment of the user fee, for filing ruling requests with that office.

(iii) *When effective.* Unless otherwise determined by the Commissioner, revocation of a section 1295 election will be effective for the first taxable year of the PFIC beginning after the date the Commissioner consents to the revocation.

(3) *Effect of invalidation, termination, or revocation.* An invalidation, termination, or revocation of a section 1295 election—

(i) Terminates all section 1294 elections, as provided in § 1.1294-1T(e), and the undistributed PFIC earnings tax liability and interest thereon are due by the due date, without regard to extensions, for the return for the last taxable year of the shareholder to which the section 1295 election applies;

(ii) In the Commissioner's discretion, results in a deemed sale of the QEF stock on the last day of the PFIC's last taxable year as a QEF, in which gain, but not loss, will be recognized and with respect to which appropriate basis and holding period adjustments will be made; and

(iii) Subjects the shareholder to any other terms and conditions that the Commissioner determines are necessary to ensure the shareholder's compliance with sections 1291 through 1297 or any other provisions of the Code.

(4) *Election after invalidation, termination, or revocation.* Without the Commissioner's consent a shareholder whose section 1295 election was invalidated, terminated, or revoked under this paragraph (i) may not make the section 1295 election with respect to the PFIC before the sixth taxable year ending after the taxable year in which the invalidation, termination, or revocation became effective.

(j) *Definitions.* For purposes of this section—

Intermediary is a nominee or shareholder of record that holds stock on behalf of the shareholder or on behalf of another person in a chain of ownership between the shareholder and the PFIC, and any di-

rect or indirect beneficial owner of PFIC stock (including a beneficial owner that is a pass through entity) in the chain of ownership between the shareholder and the PFIC.

Pass through entity is a partnership, S corporation, trust, or estate.

Shareholder has the same meaning as the term shareholder in § 1.1291-9(j)(3), except that for purposes of this section, a partnership and an S corporation also are treated as shareholders. Furthermore, unless otherwise provided, an interest holder of a pass through entity, which is treated as a shareholder of a PFIC, also will be treated as a shareholder of the PFIC.

Shareholder's election year is the taxable year of the shareholder for which it made the section 1295 election.

(k) *Effective date.* Section 1.1295-1T(b)(2)(iii), (b)(3), (b)(4), and (c) through (j) is applicable to taxable years of shareholders beginning after December 31, 1997.

Par. 12. Section 1.1295-3T is added to read as follows:

§ 1.1295-3T Retroactive elections (temporary).

(a) *In general.* This section prescribes the exclusive rules under which a shareholder, as defined in § 1.1295-1T(j), may make a section 1295 election for a taxable year after the election due date, as defined in § 1.1295-1T(e) (retroactive election). Therefore, a shareholder may not seek such relief under any other provision of the law, including § 301.9100 of this chapter. Paragraph (b) of this section describes the general rules for a shareholder to preserve the ability to make a retroactive election. These rules require that the shareholder possess reasonable belief as of the election due date that the foreign corporation was not a PFIC for its taxable year that ended in the shareholder's taxable year to which the election due date pertains, and that the shareholder file a Protective Statement to preserve its ability to make a retroactive election. Paragraph (c) of this section establishes the terms, conditions and other requirements with respect to a Protective Statement required to be filed under the general rules. Paragraph (d) of this section sets forth factors that establish a shareholder's reasonable belief that a foreign corporation

was not a PFIC. Paragraph (e) of this section prescribes special rules for certain shareholders that are deemed to satisfy the reasonable belief requirement and therefore are not required to file a Protective Statement. Paragraph (f) of this section describes the limited circumstances under which the Commissioner may permit a shareholder that lacked the requisite reasonable belief or failed to satisfy the requirements of paragraph (b) or (e) of this section to make a retroactive election. Paragraph (g) of this section provides the time for and manner of making a retroactive election. Paragraph (h) of this section provides the effective date of this section.

(b) *General rule.* Except as provided in paragraphs (e) and (f) of this section, a shareholder may make a retroactive election for a taxable year of the shareholder (retroactive election year) only if the shareholder—

(1) Reasonably believed, within the meaning of paragraph (d) of this section, as of the election due date that the foreign corporation was not a PFIC for its taxable year that ended during the retroactive election year;

(2) Filed a Protective Statement with respect to the foreign corporation, applicable to the retroactive election year, in which the shareholder described the basis for its reasonable belief and extended, in the manner provided in paragraph (c)(4) of this section, the periods of limitations on the assessment of taxes determined under sections 1291 through 1297 with respect to the foreign corporation (PFIC related taxes) for all taxable years of the shareholder to which the Protective Statement applies; and

(3) Complied with the other terms and conditions of the Protective Statement.

(c) *Protective Statement*—(1) *In general.* A Protective Statement is a statement executed under penalties of perjury by the shareholder, or a person authorized to sign a federal income tax return on behalf of the shareholder, that preserves the shareholder's ability to make a retroactive election. To file a Protective Statement that applies to a taxable year of the shareholder, the shareholder must reasonably believe as of the election due date that the foreign corporation was not a PFIC for the foreign corporation's taxable year that ended during the retroactive election year. The Protective Statement must contain—

(i) The shareholder's reasonable belief statement, as described in paragraph (c)(2) of this section;

(ii) The shareholder's agreement extending the periods of limitations on the assessment of PFIC related taxes for all taxable years to which the Protective Statement applies, as provided in paragraph (c)(4) of this section; and

(iii) The following information and representations—

(A) The shareholder's name, address, taxpayer identification number, and the shareholder's first taxable year to which the Protective Statement applies;

(B) The foreign corporation's name, address, and taxpayer identification number, if any; and

(C) The highest percentage of shares of each class of stock of the foreign corporation held directly or indirectly by the shareholder during the shareholder's first taxable year to which the Protective Statement applies.

(2) *Reasonable belief statement.* The Protective Statement must contain a reasonable belief statement, as described in paragraph (c)(1) of this section. The reasonable belief statement is a description of the shareholder's basis for its reasonable belief that the foreign corporation was not a PFIC for its taxable year that ended with or within the shareholder's first taxable year to which the Protective Statement applies. If the Protective Statement applies to a taxable year or years described in paragraph (c)(5)(ii) of this section, the reasonable belief statement must describe the shareholder's basis for its reasonable belief that the foreign corporation was not a PFIC for the foreign corporation's taxable year or years that ended in such taxable year or years of the shareholder. The reasonable belief statement must discuss the application of the income and asset tests to the foreign corporation and the factors, including those stated in paragraph (d) of this section, that affect the results of those tests.

(3) *Who executes and files the Protective Statement.* The person that executes and files the Protective Statement is the person that makes the section 1295 election, as provided in § 1.1295-1T(d).

(4) *Waiver of the periods of limitations—(i) Time for and manner of extending periods of limitations.* (A) *In general.* A shareholder that files the Protective

Statement with the Commissioner must extend the periods of limitations on the assessment of all PFIC related taxes for all of the shareholder's taxable years to which the Protective Statement applies, as provided in this paragraph (c)(4). The shareholder is required to execute the waiver on such form as the Commissioner may prescribe for purposes of this paragraph (c)(4). Until that form is published, the shareholder must execute a statement in which the shareholder agrees to extend the periods of limitations on the assessment of taxes for all the shareholder's taxable years to which the Protective Statement applies, as provided in this paragraph (c)(4), and agrees to the restrictions in paragraph (c)(4)(ii)(A) of this section. The shareholder or a person authorized to sign the shareholder's federal income tax return must sign the form or statement. A properly executed form or statement authorized by this paragraph (c)(4) will be deemed consented to and signed by a Service Center Director or the Assistant Commissioner (International) for purposes of § 301.6501(c)-1(d) of this chapter.

(B) *Application of general rule to domestic partnerships—(1) In general.* A domestic partnership that holds an interest in stock of a PFIC satisfies the waiver requirement of paragraph (c)(4) of this section pursuant to the rules of this paragraph (c)(4)(i)(B)(1). The partnership must file one or more waivers obtained or arranged under this paragraph (c)(4)(i)(B) as part of the Protective Statement, as provided in paragraph (c)(1) of this section. The partnership must either—

(i) Obtain from each partner the partner's waiver of the periods of limitations;

(ii) Obtain from each partner a duly executed power of attorney under § 601.501 of this chapter authorizing the partnership to extend that partner's periods of limitations, and execute a waiver on behalf of the partners; or

(iii) In the case of a domestic partnership governed by the unified audit and litigation procedures of sections 6221 through 6233 (TEFRA partnership), arrange for the tax matters partner (or any other person authorized to enter into an agreement to extend the periods of limitations), as provided in section 6229(b), to execute a waiver on behalf of all the partners.

(2) *Special rules—(i) Addition of partner to non-TEFRA partnership.* In

the case of any individual who becomes a partner in a domestic partnership other than a TEFRA partnership (non-TEFRA partnership) in a taxable year subsequent to the year in which the partnership filed a Protective Statement, the partner and the partnership must comply with the rules applicable to non-TEFRA partnerships, as provided in paragraph (c)(4)(i)(B)(1) of this section, by the due date, as extended, for the federal income tax return of the partnership for the taxable year during which the individual became a partner. Failure to so comply will render the Protective Statement invalid with respect to the partnership and partners.

(ii) *Change in status from non-TEFRA partnership to TEFRA partnership.* If a partnership is a non-TEFRA partnership in one taxable year but becomes a TEFRA partnership in a subsequent taxable year, the partnership must file one or more waivers obtained or arranged under this paragraph (c)(4)(i)(B)(2)(ii), as part of the Protective Statement, as provided in paragraph (c)(1) of this section. The partnership must either obtain from any new partner the partner's waiver described in this paragraph (c)(4); obtain from the new partner a duly executed power of attorney under § 601.501 of this chapter authorizing the partnership to extend the partner's periods of limitations, and execute a waiver on behalf of the new partner; or arrange for the tax matters partner (or any other person authorized to enter into an agreement to extend the periods of limitations) to execute a waiver on behalf of all the partners. In each case, the partnership must attach any new waiver of a partner's periods of limitations, and a copy of the Protective Statement to its federal income tax return for that taxable year.

(C) *Application of general rule to domestic nongrantor trusts and domestic estates.* A domestic nongrantor trust or a domestic estate that holds an interest in stock of a PFIC satisfies the waiver requirement of this paragraph (c)(4) at the entity level. For this purpose, such entity must comply with rules similar to those applicable to non-TEFRA partnerships, as provided in paragraph (c)(4)(i)(B)(1) of this section.

(D) *Application of general rule to S corporations.* An S corporation that holds an interest in stock of a PFIC satisfies the waiver requirement of this paragraph

(c)(4) at the S corporation level. For this purpose, the S corporation must comply with rules similar to those applicable to non-TEFRA partnerships, as provided in paragraph (c)(4)(i)(B)(I) of this section. However, in the case of an S corporation that was governed by the unified audit corporate proceedings of sections 6241 through 6245 for any taxable year to which a Protective Statement applies (former TEFRA S corporation), the tax matters person (or any other person authorized to enter into such an agreement), as was provided in sections 6241 through 6245, may execute a waiver described in this paragraph (c)(4) that applies to such taxable year; for any other taxable year, the former TEFRA S corporation must comply with rules similar to those applicable to non-TEFRA partnerships.

(E) *Effect on waiver of complete termination of a pass through entity or pass through entity's business.* The complete termination of a pass through entity described in paragraphs (c)(4)(i)(B) through (D) of this section, or a pass through entity's trade or business, will not terminate a waiver that applies to a partner, shareholder, or beneficiary.

(F) *Application of general rule to foreign partnerships, foreign trusts, domestic or foreign grantor trusts, and foreign estates.* A U.S. person that is a partner or beneficiary of a foreign partnership, foreign trust, or foreign estate that holds an interest in stock of a PFIC satisfies the waiver requirement of this paragraph (c)(4) at the partner or beneficiary level. A U.S. person that is treated under sections 671 through 679 as the owner of the portion of a domestic or foreign trust that owns an interest in PFIC stock also satisfies the waiver requirement at the owner level. A waiver by a partner or beneficiary applies only to that partner or beneficiary, and is not affected by a complete termination of the entity or the entity's trade or business.

(ii) *Terms of waiver*—(A) *Scope of waiver.* The waiver of the periods of limitations is limited to the assessment of PFIC related taxes. If the period of limitations for a taxable year affected by a retroactive election has expired with respect to the assessment of other non-PFIC related taxes, no adjustments, other than consequential changes, may be made by the Internal Revenue Service or by the

shareholder to any other items of income, deduction, or credit for that year. If the period of limitations for refunds or credits for a taxable year affected by a retroactive election is open only by virtue of the assessment period extension and section 6511(c), no refund or credit is allowable on grounds other than adjustments to PFIC related taxes and consequential changes.

(B) *Period of waiver.* The extension of the periods of limitations on the assessment of PFIC related taxes will be effective for all of the shareholder's taxable years to which the Protective Statement applies. In addition, the waiver, to the extent it applies to the period of limitations for a particular year, will terminate with respect to that year no sooner than three years from the date on which the shareholder files an amended return, as provided in paragraph (g) of this section, for that year. For the suspension of the running of the period of limitations for the collection of taxes for which a shareholder has elected under section 1294 to extend the time for payment, as provided in paragraph (g)(3)(ii) of this section, see sections 6503(i) and 6229(h).

(5) *Time for and manner of filing a Protective Statement*—(i) *In general.* Except as provided in paragraph (c)(5)(ii) of this section, a Protective Statement must be attached to the shareholder's federal income tax return for the shareholder's first taxable year to which the Protective Statement will apply. The shareholder also must file a copy of the Protective Statement with the Philadelphia Service Center, P.O. 21086, Philadelphia, PA 19114. The shareholder must file its return and the copy of the Protective Statement by the due date, as extended, for the return.

(ii) *Special rule for taxable years ended before January 2, 1998.* A shareholder may file a Protective Statement that applies to the shareholder's taxable year or years that ended before January 2, 1998, provided the period of limitations on the assessment of taxes for any such year has not expired (open year). The shareholder must file the Protective Statement applicable to such open year or years, as provided in paragraph (c)(5)(i) of this section, by the due date, as extended, for the shareholder's return for the first taxable year ending after January 2, 1998.

(6) *Applicability of the Protective Statement*—(i) *In general.* Except as otherwise provided in this paragraph (c)(6), a Protective Statement applies to the shareholder's first taxable year for which the Protective Statement was filed and to each subsequent taxable year. The Protective Statement will not apply to any taxable year of the shareholder during which the shareholder does not own any stock of the foreign corporation or to any taxable year thereafter. Accordingly, if the shareholder has not made a retroactive election with respect to the previously owned stock by the time the shareholder reacquires stock of the foreign corporation, the shareholder must file another Protective Statement to preserve its right to make a retroactive election with respect to the later acquired stock. For the rule that provides that a section 1295 election made with respect to a foreign corporation applies to stock of that corporation acquired after a lapse in ownership, see § 1.1295-1T(c)(2)(iii).

(ii) *Invalidity of the Protective Statement.* A shareholder will be treated as if it never filed a Protective Statement if—

(A) The shareholder failed to make a retroactive election by the date prescribed for making the retroactive election in paragraph (g)(1) of this section; or

(B) The waiver of the periods of limitations terminates (by reason of a court decision or other determination) with respect to any taxable year before the expiration of three years from the date of filing of an amended return for that year pursuant to paragraph (g) of this section.

(7) *Retention of Protective Statement and information demonstrating reasonable belief.* A shareholder that files a Protective Statement must retain a copy of the Protective Statement and its attachments and must, for each taxable year of the shareholder to which the Protective Statement applies, retain information sufficient to demonstrate the shareholder's reasonable belief that the foreign corporation was not a PFIC for the taxable year of the foreign corporation ending during each such taxable year of the shareholder.

(d) *Reasonable belief*—(1) *In general.* A foreign corporation is a PFIC for a taxable year if the foreign corporation satisfies either the income or asset test of section 1296(a). To determine whether a shareholder had reasonable belief that the

foreign corporation is not a PFIC under section 1296(a), the shareholder must consider all relevant facts and circumstances. Reasonable belief may be based on a variety of factors, including reasonable asset valuations as well as reasonable interpretations of the applicable provisions of the Code, regulations, and administrative guidance regarding the direct or indirect ownership of the income or assets of the foreign corporation, the proper character of that income or those assets, and similar issues. Reasonable belief may be based on reasonable predictions regarding income to be earned and assets to be owned in subsequent years where qualification of the foreign corporation as a PFIC for the current taxable year will depend on the qualification of the corporation as a PFIC in a subsequent year. Reasonable belief may be based on an analysis of generally available financial information of the foreign corporation. To determine whether a shareholder had reasonable belief that the foreign corporation was not a PFIC, the Commissioner may consider the size of the shareholder's interest in the foreign corporation.

(2) *Knowledge of law required.* Reasonable belief must be based on a good faith effort to apply the Code, regulations, and related administrative guidance. Any person's failure to know or apply these provisions will not form the basis of reasonable belief.

(e) *Special rules for qualified shareholders*—(1) *In general.* A shareholder that is a qualified shareholder, as defined in paragraph (e)(2) of this section, for a taxable year of the shareholder is not required to satisfy the reasonable belief requirement of paragraph (b)(1) of this section or file a Protective Statement to preserve its ability to make a retroactive election with respect to such taxable year. Accordingly, a qualified shareholder may make a retroactive election for any open taxable year in the shareholder's holding period. The retroactive election will be treated as made in the earliest taxable year of the shareholder during which the foreign corporation qualified as a PFIC (including a taxable year ending prior January 2, 1998) and the shareholder will be treated as a shareholder of a pedigreed QEF, as defined in § 1.1291-9(j)(2)(ii), provided the shareholder—

(i) Has been a qualified shareholder with respect to the foreign corporation for all taxable years of the shareholder included in the shareholder's holding period during which the foreign corporation was a PFIC, or in the case of taxable years ending before January 2, 1998, the shareholder satisfies the criteria of a qualified shareholder, for all such years; or

(ii) Has been a qualified shareholder, or in the case of taxable years ending before January 2, 1998, satisfies the criteria of a qualified shareholder, for all taxable years in its holding period before it filed a Protective Statement, which Protective Statement is applicable to all subsequent years, beginning with the first taxable year in which the shareholder is not a qualified shareholder.

(2) *Qualified shareholder.* A shareholder will be treated as a qualified shareholder for a taxable year if the shareholder did not file a Protective Statement applicable to an earlier taxable year included in the shareholder's holding period of the stock of the foreign corporation currently held and—

(i) At all times during the taxable year the shareholder owned, within the meaning of section 958, directly, indirectly, or constructively, less than two percent of the vote and value of each class of stock of the foreign corporation; and

(ii) With respect to the taxable year of the foreign corporation ending within the shareholder's taxable year, the foreign corporation or U.S. counsel for the foreign corporation indicated in a public filing, disclosure statement or other notice provided to U.S. persons that are shareholders of the foreign corporation (corporate filing) that the foreign corporation—

(A) Reasonably believes that it is not or should not constitute a PFIC for the corporation's taxable year; or

(B) Is unable to conclude that it is not or should not be a PFIC (due to certain asset valuation or interpretation issues, or because PFIC status will depend on the income or assets of the foreign corporation in the corporation's subsequent taxable years) but reasonably believes that, more likely than not, it ultimately will not be a PFIC.

(3) *Exceptions.* Notwithstanding paragraph (e)(2)(ii) of this section, a shareholder will not be treated as a qualified

shareholder for a taxable year of the shareholder if the shareholder knew or had reason to know that a corporate filing regarding the foreign corporation's PFIC status was inaccurate, or knew that the foreign corporation was a PFIC for the taxable year of the foreign corporation ending with or within such taxable year of the shareholder. For purposes of this paragraph, a shareholder will be treated as knowing that a foreign corporation was a PFIC if the principal activity of the foreign corporation, directly or indirectly, is owning or trading a diversified portfolio of stock, securities, or other financial contracts.

(f) *Special consent*—(1) *In general.* A shareholder that has not satisfied the requirements of paragraph (b) or (e) of this section may request the consent of the Commissioner to make a retroactive election for a taxable year of the shareholder provided the shareholder satisfies the requirements set forth in this paragraph (f). The Commissioner will grant relief under this paragraph (f) only if—

(i) The shareholder reasonably relied on a qualified tax professional, within the meaning of paragraph (f)(2) of this section;

(ii) Granting consent will not prejudice the interests of the United States government, as provided in paragraph (f)(3) of this section;

(iii) The shareholder requests consent under paragraph (f) of this section 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

(iv) The shareholder satisfies the procedural requirements set forth in paragraph (f)(4) of this section.

(2) *Reasonable reliance on a qualified tax professional*—(i) *In general.* Except as provided in paragraph (f)(2)(ii) of this section, a shareholder is deemed to have reasonably relied on a qualified tax professional only if the shareholder reasonably relied on a qualified tax professional (including a tax professional employed by the shareholder) 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, the section 1295 election. 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 the availability of a section 1295 election, or knew or reasonably should have known that the qualified tax professional—

(A) Was not competent to render tax advice with respect to the ownership of shares of a foreign corporation; or

(B) Did not have access to all relevant facts and circumstances.

(ii) *Shareholder deemed to have not reasonably relied on a qualified tax professional.* For purposes of this paragraph (f)(2), a shareholder is deemed to have not reasonably relied on a qualified tax professional if the shareholder was informed by the qualified tax professional that the foreign corporation was a PFIC and of the availability of the section 1295 election and related tax consequences, but either chose not to make the section 1295 election or was unable to make a valid section 1295 election.

(3) *Prejudice to the interests of the United States government—(i) General rule.* Except as otherwise provided in paragraph (f)(3)(ii) of this section, the Commissioner will not grant consent under paragraph (f) of this section if doing so would prejudice the interests of the United States government. The interests of the United States 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.

(ii) *Elimination of prejudice to the interests of the United States government.* Notwithstanding the general rule of paragraph (f)(3)(i) of this section, if granting relief would prejudice the interests of the United States government, the Commissioner may, in the Commissioner's 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 United States government as a consequence of the shareholder's inability

to file amended returns for closed taxable years.

(4) *Procedural requirements—(i) Filing instructions.* A shareholder requests consent under paragraph (f) of this section to make a retroactive election by filing with the Office of the Associate Chief Counsel (International) a ruling request that includes the affidavits required by this paragraph (f)(4). The ruling request must satisfy the requirements, including payment of the user fee, for ruling requests filed with that office.

(ii) *Affidavit from shareholder.* The shareholder, or a person authorized to sign a federal income tax return on behalf of the shareholder, must submit a detailed affidavit describing the events that led to the failure to make a section 1295 election by the election due date, and to the discovery thereof. The shareholder's affidavit must describe the engagement and responsibilities of the qualified tax professional as well as the extent to which the shareholder relied on the tax professional. The shareholder must sign the affidavit under penalties of perjury. An individual who signs for an entity must have personal knowledge of the facts and circumstances at issue.

(iii) *Affidavits from other persons.* The shareholder must submit detailed affidavits from individuals having knowledge or information about the events that led to the failure to make a section 1295 election by the election due date, and to the discovery thereof. These individuals must include the qualified tax professional upon whose advice the shareholder relied, as well as any individual (including an employee of the shareholder) who made a substantial contribution to the return's preparation, and any accountant or attorney, knowledgeable in tax matters, who advised the shareholder with regard to its ownership of the stock of the foreign corporation. Each affidavit must describe the individual's engagement and responsibilities as well as the advice concerning the tax treatment of the foreign corporation that the individual provided to the shareholder. Each affidavit also must include the individual's name, address, and taxpayer identification number, and must be signed by the individual under penalties of perjury.

(iv) *Other information.* In connection with a request for consent under this para-

graph (f), a shareholder must provide any additional information requested by the Commissioner.

(v) *Notification of Internal Revenue Service.* The shareholder must notify the branch of the Associate Chief Counsel (International) considering the request for relief under this paragraph (f) if, while the shareholder's request for consent is pending, the Internal Revenue Service begins an examination of the shareholder's return for the retroactive election year or for any subsequent taxable year during which the shareholder holds stock of the foreign corporation.

(vi) *Who requests special consent under this paragraph (f) and who enters into a closing agreement.* The person that requests consent under this paragraph (f) is the person that makes the section 1295 election, as provided in § 1.1295-1T(d). If a shareholder is required to enter into a closing agreement with the Commissioner, as described in paragraph (f)(3)(ii) of this section, rules similar to those under paragraphs (c)(4)(i)(B) through (E) of this section apply for purposes of determining the person that enters into the closing agreement.

(g) *Time for and manner of making a retroactive election—(1) Time for making a retroactive election—(i) In general.* Except as otherwise provided in paragraph (g)(1)(ii) of this section, a shareholder must make a retroactive election, in the manner provided in paragraph (g)(2) of this section, on or before the due date, as extended, for the shareholder's return—

(A) In the case of a shareholder that makes a retroactive election pursuant to paragraph (b) or (e) of this section, for the taxable year in which the shareholder determines or reasonably should have determined that the foreign corporation was a PFIC; or

(B) In the case of a shareholder that obtains the consent of the Commissioner pursuant to paragraph (f) of this section, for the taxable year in which such consent is granted.

(ii) *Transition rule.* A shareholder that files a Protective Statement for a taxable year described in paragraph (c)(5)(ii) of this section may make a retroactive election by the due date, as extended, for the return for the first taxable year ended after January 2, 1998, even if the shareholder

determined or should have determined that the foreign corporation was a PFIC for a year described in paragraph (c)(5)(ii) of this section at any time on or before January 2, 1998.

(iii) *Ownership not required at time retroactive election is made.* The shareholder need not own shares of the foreign corporation at the time the shareholder makes a retroactive election with respect to the foreign corporation.

(2) *Manner of making a retroactive election.* A shareholder that has satisfied the requirements of paragraph (b) or (e) of this section, or a shareholder that has been granted consent under paragraph (f) of this section, must make a retroactive election in the manner provided in Form 8621 for making a section 1295 election, and must attach Form 8621 to an amended return for the later of the retroactive election year or the earliest open taxable year of the shareholder. The shareholder also must file an amended return for each of its subsequent taxable years affected by the retroactive election. In each amended return the shareholder must redetermine its income tax liability for that year to take into account the assessment of PFIC related taxes. If the period of limitations for the assessment of taxes for a taxable year affected by the retroactive election has expired except to the extent the waiver of limitations, described in paragraph (c)(4) of this section, has extended such period, no adjustments, other than consequential changes, may be made to any other items of income, deduction, or credit in that year. In addition, the shareholder must pay all taxes and interest owing by reason of the PFIC and QEF status of the foreign corporation in those years (except to the extent a section 1294 election extends the time to pay the taxes and interest). A shareholder that filed a Protective Statement must attach to Form 8621 filed with each amended return a representation that the shareholder, until the taxable year in which it determined or reasonably should have determined that the foreign corporation was a PFIC, reasonably believed, within the meaning of paragraph (d) of this section, that the foreign corporation was not a PFIC in the taxable year for which the amended return is filed, and in all other taxable years to which the Protective Statement applies. A shareholder that entered into a closing agreement must comply with

the terms of that agreement, as provided in paragraph (f)(3)(ii) of this section, to eliminate any prejudice to the United States government's interests, as described in paragraph (f)(3) of this section.

(3) *Who makes the retroactive election.* The person that makes the retroactive election is the person that makes the section 1295 election, as provided in § 1.1295-1T(d). A partner, shareholder, or beneficiary for which a pass through entity, as described in paragraphs (c)(4)(i)(B) through (D) of this section, filed a Protective Statement may make a retroactive election, if the pass through entity completely terminates its business or otherwise ceases to exist.

(4) *Other elections—(i) Section 1291(d)(2) election.* If the foreign corporation for which the shareholder makes a retroactive election will be treated as an unpedigreed QEF, as defined in § 1.1291-9(j)(2)(iii), with respect to the shareholder, the shareholder may make an election under section 1291(d)(2) to purge its holding period of the years or parts of years before the effective date of the retroactive election. If the qualification date, within the meaning of § 1.1291-9(e) or 1.1291-10(e), falls in a taxable year for which the period of limitations has expired, the shareholder may treat the first day of the retroactive election year as the qualification date. The shareholder may make a section 1291(d)(2) election at the time that it makes the retroactive election, but no later than two years after the date that the amended return in which the retroactive election is made is filed. For the requirements for making a section 1291(d)(2) election, see §§ 1.1291-9 and 1.1291-10.

(ii) *Section 1294 election.* A shareholder may make an election under section 1294 to extend the time for payment of tax on the shareholder's pro rata shares of the ordinary earnings and net capital gain of the foreign corporation reported in the shareholder's amended return, and section 6621 interest attributable to such tax, but only to the extent the tax and interest are attributable to earnings that have not been distributed to the shareholder. The shareholder must make a section 1294 election for a taxable year at the time that it files its amended return for that year, as provided in paragraph (g)(1) of this section. For the requirements for

making a section 1294 election, see § 1.1294-1T.

(h) *Effective date.* The rules of this section are effective as of January 2, 1998.

Par. 13. Section 1.1297-3T(c) is added to read as follows:

§ 1.1297-3T Deemed sale election by a United States person that is a shareholder of a passive foreign investment company (temporary).

* * * * *

(c) *Application of deemed dividend election rules—(1) In general.* A shareholder of a former PFIC, within the meaning of § 1.1291-9(j)(2)(iv), that was a controlled foreign corporation, within the meaning of section 957(a) (CFC), during its last taxable year as a PFIC under section 1296(a), may apply the rules of section 1291(d)(2)(B) and § 1.1291-9 to an election under section 1297(b)(1) and this section made by the time and in the manner provided in paragraph (b) of this section.

(2) *Transition rule.* If the time for making an election under this section, as provided in paragraph (b) of this section, expired before January 2, 1998, a shareholder that applied rules similar to the rules of section 1291(d)(2)(A) and § 1.1291-10 to an election under this section made with respect to a corporation that was a CFC during its last taxable year as a PFIC under section 1296(a) may file an amended return for the taxable year that includes the termination date, as defined in paragraph (a) of this section, and apply the rules of section 1291(d)(2)(B) and § 1.1291-9 at any time before the expiration of the period of limitations for the assessment of taxes for that taxable year.

(3) *Effective date.* The rules of this paragraph are effective as of January 2, 1998.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 14. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§602.101 [Amended]

Par. 15. In § 602.101, paragraph (c) is amended by adding entries in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

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(c) * * *

CFR part or section where identified and described	Current OMB Control No.
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1.1295-1T1545-1555

1.1295-3T1545-1555

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Michael P. Dolan,
*Deputy Commissioner of
Internal Revenue.*

Approved December 15, 1997.

Donald C. Lubick,
*Acting Assistant Secretary of
the Treasury.*

(Filed by the Office of the Federal Register on December 31, 1997, 8:45 a.m., and published in the issue of the Federal Register for January 2, 1998, 63 F.R. 6)