

FACTS

Shareholder is treated as a regulated investment company (RIC) under subchapter M of the Internal Revenue Code. Shareholder's taxable year ends on Date 1. Shareholder routinely invests in companies that are PFICs within the meaning of section 1297(a).

As a general practice, when a PFIC provides a PFIC annual information statement (PFIC Statement) described in Treas. Reg. § 1.1295-1(g)(1), Shareholder elects to treat that PFIC as a qualified electing fund (QEF) within the meaning of section 1295 in the year in which it acquires the stock of the PFIC. Not all PFICs in which Shareholder acquires stock provide PFIC Statements to their shareholders. For those that do not provide a PFIC Statement to their shareholders, Shareholder generally elects to make an MTM election under section 1296 with respect to such stock.

Shareholder acquired an interest in FC on Date 2, which was during Taxable Year 1. FC is a foreign corporation that was a PFIC in its Year 1 and Year 2 taxable years. FC did not inform Shareholder that PFIC Statements were available until after Taxable Year 1 had ended. Because Shareholder was not aware that PFIC Statements were available, for Taxable Year 1, Shareholder made an MTM election with respect to its stock in FC.

At all relevant times, Shareholder, which was treated as a RIC, offered for sale and had outstanding stock of which it was the issuer and which was redeemable at its net asset value. Accordingly, in the year of acquisition, stock in the FC constituted "marketable stock" under section 1296(e)(2) and Treas. Reg. § 1.1296-2(f). With respect to FC, in Taxable Year 1, Shareholder included amounts in gross income under section 1296(a)(1) and has adjusted its basis in FC pursuant to section 1296(b) accordingly.

After Date 3, which was the due date of Shareholder's Taxable Year 1 return, Shareholder learned that PFIC Statements were available for FC. Shareholder would like to make a QEF election with respect to its stock in FC but cannot do so while its MTM election is in effect. An MTM election can be revoked only with the consent of the Commissioner "upon a finding of a substantial change in circumstances" within the meaning of Treas. Reg. § 1.1296-1(h)(3).

Shareholder represents that, if the ruling request is granted, it intends to file a QEF election for FC with its tax return for Taxable Year 2.

RULING REQUESTED

Shareholder requests the consent of the Commissioner to revoke its MTM Election with respect to FC for Shareholder's Taxable Year 2 based on a finding of a substantial change in circumstances, with the following consequences:

- (1) Section 1296 ceases to apply to Shareholder with respect to FC beginning with Shareholder's Taxable Year 2;
- (2) Pursuant to Treasury Regulation § 1.1296-1(g), solely for purposes of sections 1291 through 1298, Shareholder's holding period in FC is treated as beginning on Date 5;
- (3) Provided Shareholder makes a valid QEF election for FC for Taxable Year 2, FC is a "pedigreed QEF" within the meaning of Treasury Regulation § 1.1291-1(b)(2)(ii) with respect to Shareholder; and
- (4) Shareholder's stock basis in FC includes the basis adjustment allowed pursuant to section 1296(b) and the regulations thereunder.

LAW

Section 1297(a) provides that the term "PFIC" means any foreign corporation if (i) 75 percent or more of the gross income of the corporation for the taxable year is passive income; or (ii) the average percentage of assets (as determined in accordance with section 1297(e)) held by the corporation during the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent.

Section 1296(a) provides that, in the case of marketable stock in a PFIC that is owned (or treated as owned under section 1296(g)) by a United States person at the close of any taxable year, the United States person may elect to include in gross income the excess of the fair market value of the stock over its adjusted basis or, if the adjusted basis exceeds the fair market value of the stock, deduct the lesser of the excess or the unreversed inclusions.

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

Under section 1296(b)(1), the adjusted basis of stock in a PFIC is increased by the amount included in the gross income of the United States person under section

1296(a)(1) with respect to the stock and is decreased by the amount allowed as a deduction to the United States person under section 1296(a)(2) with respect to the stock.

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

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

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

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

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

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

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

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

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

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

ANALYSIS

Revocation of MTM Election.

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

In order for Shareholder to make a QEF election for FC, FC would have had to issue PFIC Statements, as required under Treas. Reg. § 1.1295-1(g). However, FC did not inform Shareholder that it would provide PFIC Statements prior to the end of Shareholder's Taxable Year 1. Shareholder did not discover that FC would provide

PFIC Statements until after Shareholder filed its Taxable Year 1 tax return; therefore, Shareholder could not make a QEF election for FC in Taxable Year 1.

Subsequently, during Taxable Year 2 and after it had filed its Taxable Year 1 tax return, Shareholder discovered that FC was preparing and issuing PFIC Statements to shareholders, enabling shareholders who are U.S. persons (who do not have MTM elections in place) to make QEF elections. The discovery of the decision by FC to issue PFIC Statements was a change in the circumstances of Shareholder's ownership in FC that was outside the control of Shareholder. Therefore, based on the facts described in this letter, FC's beginning to issue PFIC Statements constitutes a substantial change in circumstances for purposes of Treas. Reg. § 1.1296-1(h)(3)(i), and the Commissioner hereby consents to revoke Shareholder's MTM election for FC.

Year of Revocation.

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

Shareholder requested that its MTM election for FC be revoked effective for Taxable Year 2. Under Treas. Reg. § 1.1296-1(h)(3)(ii), Shareholder's MTM election would cease to apply beginning with Shareholder's first taxable year after the revocation is granted unless otherwise provided by the Commissioner.

Shareholder's Taxable Year 2 had already ended prior to the date of its request (and prior to the date of this letter), but the taxable year was still open at the date of the request and Shareholder has not yet filed its Taxable Year 2 return, which is not due until Date 4. Under the general rule of Treas. Reg. § 1.1296-1(h)(3)(ii), the revocation of the MTM elections for FC would be effective for Shareholder's Taxable Year 3. However, based on the facts described, and because Shareholder has not yet filed its Taxable Year 2 tax return, the revocation of Shareholder's MTM elections for FC is effective for Taxable Year 2.

Holding Period.

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

Shareholder's Taxable Year 1, the Taxable Year 1 is the last year for which section 1296 applied. As a result, Shareholder's holding period, for purposes of sections 1291 through 1298, with respect to FC began on Date 5, the first day of Shareholder's Taxable Year 2.

Pedigreed QEF Status.

Treas. Reg. § 1.1291-1(b)(2)(ii) provides that a PFIC is a pedigreed QEF with respect to a shareholder if the PFIC has been a QEF with respect to the shareholder for all taxable years during which it was a PFIC that are included, wholly or partly, within the shareholder's holding period for the PFIC stock. As discussed above, through the application of Treas. Reg. § 1.1296-1(f), for purposes of sections 1291 through 1298, Shareholder's holding period with respect to the stock of FC began on Date 5, the first day of Shareholder's Taxable Year 2.

Shareholder has represented that if its ruling request is granted, it will make a QEF election for FC with its Taxable Year 2 return. Therefore, provided that Shareholder properly makes a QEF election for FC with its Taxable Year 2 return, FC would be a pedigreed QEF with respect to Shareholder.

Basis.

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

CONCLUSIONS

Based on the information and representations submitted, Shareholder's request for consent to revoke its MTM election, effective for its Taxable Year 2, is granted.

In addition, as a result of the revocation of Shareholder's MTM election, we conclude that: (i) the revocation is effective as of the end of Shareholder's Taxable Year 1 and section 1296 ceases to apply to Shareholder beginning with Shareholder's Taxable Year 2; (ii) pursuant to Treas. Reg. § 1.1296-1(f), solely for purposes of sections 1291 through 1298, Shareholder's holding period FC is treated as beginning on Date 5; (iii) FC is a pedigreed QEF, within the meaning of Treas. Reg. § 1.1291-1(b)(2)(ii) with respect to Shareholder, provided that Shareholder properly makes a QEF election for

FC for its Taxable Year 1; and (iv) Shareholder's basis in FC includes the basis adjustments made pursuant to section 1296(b).

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

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

/s/ Melinda E. Harvey

Melinda E. Harvey
Branch Chief, Branch 2
Associate Chief Counsel (International)

cc: