



an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

#### A. Facts

Taxpayer is treated as a regulated investment company ("RIC") under subchapter M of the Internal Revenue Code. Taxpayer's taxable year ends on Date 1.

Taxpayer represented that its investment objective is to seek long-term capital appreciation. It seeks to achieve its investment objective primarily by allocating its assets among investments in private investment vehicles, commonly referred to as hedge funds, that are managed by unaffiliated asset managers that employ a broad range of investment strategies. As a secondary strategy, Taxpayer will generally also make direct investments in securities and other financial instruments. Taxpayer routinely invests in companies that are passive foreign investment companies ("PFICs") within the meaning of section 1297.

Taxpayer acquired an interest in FC1 on Date 2, Year 1 and in and FC2 on Date 3, Year 3. The taxable year of each FC ends on Date 4. FC1 and FC2 were foreign corporations that were PFICs in the years Taxpayer first acquired an interest in them and in each relevant subsequent year.

As a general practice, Taxpayer elects to treat PFICs that provide a PFIC Annual Information Statement ("PFIC Statement") described in Treas. Reg. §1.1295-1(g)(1) as a qualified electing fund ("QEF") within the meaning of section 1295 in the year of acquisition. However, if PFICs do not provide a PFIC Statement, Taxpayer generally elects to make a MTM election under section 1296 with respect to their stock.

FC1 and FC2 did not provide PFIC Statements to Taxpayer for their taxable years that ended within Taxpayer's taxable years in which it acquired their stock, i.e., Taxpayer's taxable year ended on Date 1, Year 2 with respect to FC1, and Taxpayer's taxable year ended on Date 1, Year 4 with respect to FC2 (each, an "Acquisition Year," or together "Acquisition Years"), and in each relevant subsequent year. Therefore, Taxpayer was not able to elect to treat FC1 or FC2 as a QEF for the Acquisition Years and each relevant subsequent year.

At all relevant times, Taxpayer, 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, under section 1296(e)(2) and Treas. Reg. §1.1296-2(f), Taxpayer's stock in FC1 and FC2 was treated as marketable stock for purposes of section 1296 for each Acquisition Year and each relevant subsequent year. Taxpayer made an MTM election with respect to FC1 and FC2 stock under section 1296 and Treas. Reg. §1.1296-1 for each Acquisition Year. Taxpayer's MTM election for FC1 and FC2 has remained in effect for each succeeding taxable year.

Taxpayer has included amounts in gross income under section 1296(a)(1) or deducted amounts under section 1296(a)(2), as appropriate under a MTM election, and has adjusted its basis in FC1 and FC2 stock, pursuant to section 1296(b), for the Acquisition Year and each subsequent taxable year.

In Month X of Year 6, Taxpayer contacted FC1 and FC2 and inquired whether they had changed their policies regarding issuing PFIC Statements. FC1 and FC2 responded that they had prepared PFIC Statements for their taxable years ended on Date 4, Year 5 and sent a copy of their respective PFIC Statements to Taxpayer shortly thereafter.

Taxpayer would like to make QEF elections with respect to FC1 and FC2 but cannot do so while their MTM elections are in effect. In Month X of Year 6, Taxpayer's tax advisors informed Taxpayer of the possibility of requesting permission from the Internal Revenue Service to revoke the MTM elections for FC1 and FC2 on the basis that the FCs' change in policy regarding issuing PFIC Statements was a "substantial change in circumstances."

Taxpayer represents that, if the ruling request is granted, it intends to file QEF elections for FC1 and FC2 with its tax return for its taxable year ending Date 1, Year 7 (the due date of which has not yet passed).

#### B. Rulings Requested

Taxpayer requests the consent of the Commissioner to revoke its MTM elections with respect to FC1 and FC2 for its taxable year ended on Date 1, Year 6, with the following consequences:

(1) Section 1296 ceases to apply to Taxpayer with respect to FC1 and FC2 beginning on Date 2, Year 6;

(2) Pursuant to Treas. Reg. §1.1296-1(f), solely for purposes of sections 1291 through 1298, Taxpayer's holding periods in FC1 and FC2 are treated as beginning on Date 2, Year 6;

(3) Provided Taxpayer makes valid QEF elections for FC1 and FC2 for the taxable year beginning on Date 2, Year 6, FC1 and FC2 are each a "pedigreed QEF" within the meaning of Treas. Reg. §1.1291-1(b)(2)(ii) with respect to Taxpayer; and

(4) Taxpayer's stock basis in FC1 and FC2 includes the basis adjustments allowed pursuant to section 1296(b) and the regulations thereunder.

#### C. 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 with respect to such stock (MTM election).

Under section 1296(e)(2), in the case of any RIC which is offering for sale or has outstanding any stock of which it is the issuer and which 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 a 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 a 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.

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 section 1295 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 is 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).

#### D. Analysis

##### Revocation of MTM Elections.

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, and 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.

By way of comparison, section 1295(b)(1) similarly provides that a QEF election can be revoked with the consent of the Secretary, and Treas. Reg. §1.1295-1(i)(2)(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." Just as with the revocation of the MTM election, there are no specific guidelines for what constitutes a substantial change in circumstances. However, Treas. Reg. §1.1295-1(i)(2)(ii) requires that the shareholder must request consent to revoke its QEF election no later than 12 calendar months following the discovery of the substantial change in circumstances.

In order for Taxpayer to have made a QEF election for FC1 and FC2 in the respective Acquisition Years, FC1 and FC2 would have had to have issued PFIC Statements, as required under Treas. Reg. §1.1295-1(g). However, FC1 and FC2 did not issue PFIC Statements to their shareholders, including Taxpayer, in the Acquisition Years or for any of their taxable years ending prior to Date 4, Year 5.. As a result, Taxpayer could not make QEF elections for FC1 and FC2 in the Acquisition Years or any of its taxable years ending on or prior to Date 1, Year 6.

Subsequently, in Month X of Year 6, Taxpayer discovered that FC1 and FC2 had changed their policy and were now preparing and issuing PFIC Statements to their shareholders, enabling shareholders who are U.S. persons (who do not have MTM elections in place) to make QEF elections. The decision by FC1 and FC2 to start issuing PFIC Statements was a change in the circumstances of FC1 and FC2 that was outside Taxpayer's control. In addition, Taxpayer filed its request for Commissioner's consent to revoke the MTM elections for FC1 and FC2 less than 12 calendar months from discovering FC1's and FC2's policy changes. Therefore, based on the facts described in this letter, FC1 and FC2 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 Taxpayer's MTM elections for FC1 and FC2 .

Year of Revocation.

Treas. Reg. §1.1296-1(h)(3)(ii) provides that, when an MTM election is revoked with the consent of the Commissioner, the revocation is effective for the first taxable year of the shareholder following the consent of the Commissioner, unless otherwise provided by the Commissioner. Under this general rule, Taxpayer's revocation of the MTM elections for FC1 and FC2 would be effective for Taxpayer's taxable year beginning on Date 2, Year 7 and ending on Date 1, Year 8.

Taxpayer is requesting that its MTM elections with respect to FC1 and FC2 be revoked as of Date 1, Year 6 to be effective beginning Date 2, Year 6, which is the beginning of Taxpayer's first taxable year which begins in FC1's and FC2's taxable years for which a PFIC Statement was available. Taxpayer's taxable year that began on Date 2, Year 6 and ended Date 1, Year 7 was still open at the date of its request, and Taxpayer's tax return for that taxable year has not been filed and is not yet due. Thus, based on the facts described, and because Taxpayer has not yet filed its tax returns for its taxable year ending on Date 1, Year 7, the revocations of Taxpayer's MTM elections for FC1 and FC2 are effective for the taxable year beginning Date 2, Year 6 and ending on Date 1, Year 7.

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 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. In this case, because the MTM elections for FC1 and FC2 are revoked as of the end of Taxpayer's taxable year that ended on Date 1, Year 6, the taxable year ended on Date 1, Year 6 is the last year for which section 1296 applied. As a result, Taxpayer's holding periods, for purposes of sections 1291 through 1298, with respect to FC1 and FC2 stock, began on Date 2, Year 6.

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, Taxpayer's holding periods with respect to the stock of FC1 and FC2 began on Date 2, Year 6. Taxpayer has represented that if its ruling request is granted, it will make QEF elections for FC1 and FC2 with its tax returns for the taxable year beginning on Date 2, Year 6 and ending on Date 1, Year 7. Therefore, provided that Taxpayer properly makes QEF elections for FC1 and FC2 with its tax returns for the taxable year

beginning on Date 2, Year 6 and ending on Date 1, Year 7, FC1 and FC2 would each be a pedigreed QEF with respect to Taxpayer.

#### Basis.

Section 1296(b) requires a shareholder who has made a 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). These adjustments are not disregarded after a revocation of an MTM election.

#### E. Conclusions

Based on the information and representations submitted, Taxpayer's requests to revoke its MTM elections for FC1 and FC2 for the taxable year ended on Date 1, Year 6 is granted.

In addition, as a result of the revocations of Taxpayer's MTM elections, we conclude that: (i) the revocations are effective as of Date 1, Year 6 and section 1296 ceases to apply to Taxpayer beginning with Taxpayer's taxable year beginning Date 2, Year 6; (ii) pursuant to Treas. Reg. §1.1296-1(f), solely for purposes of sections 1291 through 1298, Taxpayer's holding periods in FC1 and FC2 stock are treated as beginning on Date 2, Year 6; (iii) FC1 and FC2 are each a pedigreed QEF, within the meaning of Treas. Reg. §1.1291-1(b)(2)(ii) with respect to Taxpayer, provided that Taxpayer properly makes QEF elections for FC1 and FC2 for its taxable year beginning on Date 2, Year 6 and ending on Date 1, Year 7; and (iv) Taxpayer's bases in FC1 and FC2 stock include 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 taxpayers 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.

Sincerely,

Kristine A. Crabtree

Senior Technical Reviewer, Branch 2  
Office of the Associate Chief Counsel  
(International)

cc: