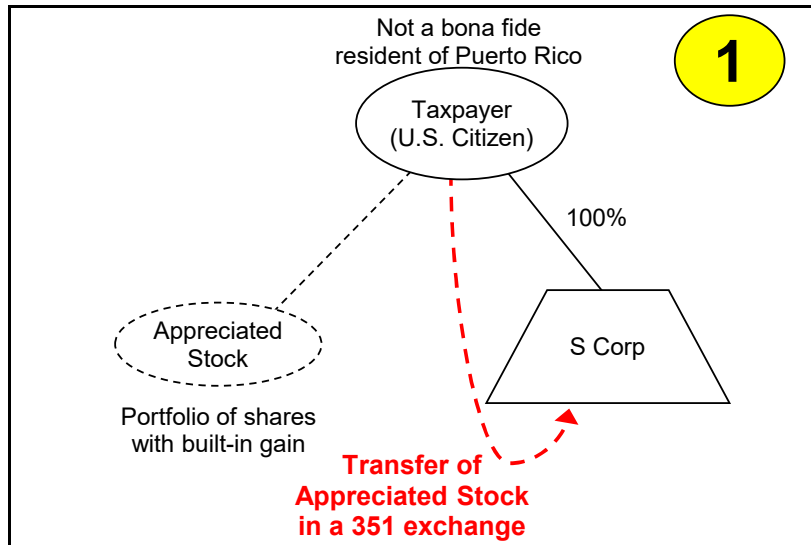
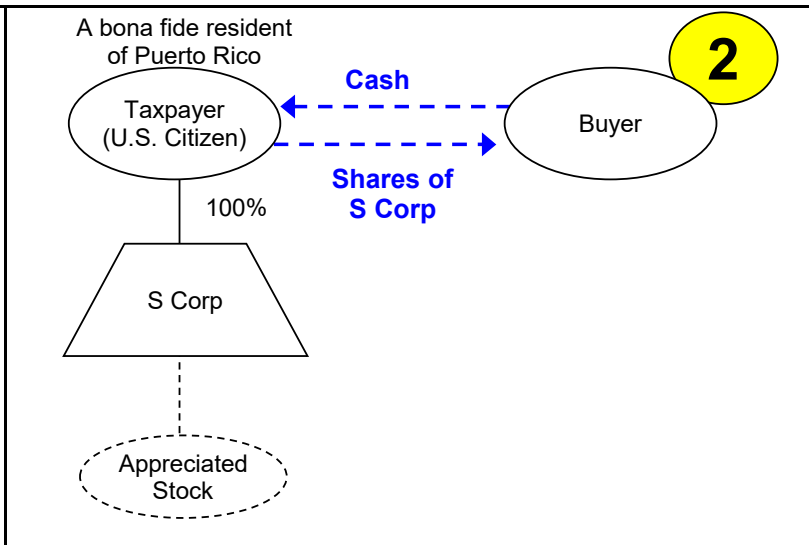


Sale of S Corp Shares Two Years After Moving to Puerto Rico

351 Exchange Before Moving to Puerto Rico



Sale of S Corp Shares Two Years After Moving to Puerto Rico



A citizen of the U.S. (“Taxpayer”) owns a portfolio of shares with built-in gain (“Appreciated Stock”). Taxpayer also owns all the shares of stock of an S corporation. Taxpayer transfers the Appreciated Stock to the S corporation in a section 351 exchange. The S corporation holds no other property, and the Taxpayer is not a dealer in securities. Taxpayer is not a bona fide resident of Puerto Rico during this period. Thereafter, Taxpayer moves to Puerto Rico and becomes a bona fide resident of Puerto Rico. Taxpayer continues to be a U.S. citizen.

Two years after moving to Puerto Rico, Taxpayer sells shares of S corporation stock for a gain. Taxpayer has a tax home outside the U.S. and is a nonresident for purposes of section 865. Thus, the gain is not U.S.-sourced under the sourcing rules of sections 861 through 865. However, the ten-year lookback rule in Reg. 1.937-2(f)(1)(i) applies. If Taxpayer makes no election under Reg. 1.937-2(f)(1)(vi), none of the gain is Puerto Rican-source income, and none of the gain can be excluded from gross income under section 933.

The result would be the same if the section 351 exchange occurred after Taxpayer became a bona fide resident of Puerto Rico. See Reg. 1.937-2(f)(1)(iv).

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