

865(h)(2)(A) Election to Treat Gain on Sale of Foreign Stock as Foreign Source

Individual A is a U.S. citizen who had her tax home in the U.S. Individual A held interests in several partnerships. These partnerships held stock in foreign corporations established in Country X. The partnerships sold stock in these foreign corporations. Individual A was allocated capital gain from these sales for U.S. tax purposes and was subject to tax in Country X with respect to the sales.

Generally, income from the sale of personal property by a U.S. resident is sourced in the U.S., and this rule applies at the partner level. Under section 865(h)(2)(A), gain from the sale of stock in a foreign corporation (i) which would be U.S.-source income under section 865, (ii) which under a treaty obligation would be sourced outside the U.S., and (iii) with respect to which the taxpayer chooses the benefits of section 865(h), is treated as foreign-source income, but is subject to its own foreign tax credit limitation.

Article 13 of the Country X treaty states that each country can tax capital gains in accordance with its domestic law. Paragraph 3 of Article 25 of the treaty provides that, for the purposes of allowing relief from double taxation, income derived by a resident of one of the countries, which may be taxed in the other country under the Treaty, is deemed to arise in that other country.

In this PLR, Individual A had not originally treated the gains as foreign-source income, but she was granted an extension of time to make the election under section 865(h)(2)(A) and treat the gains as foreign source.

