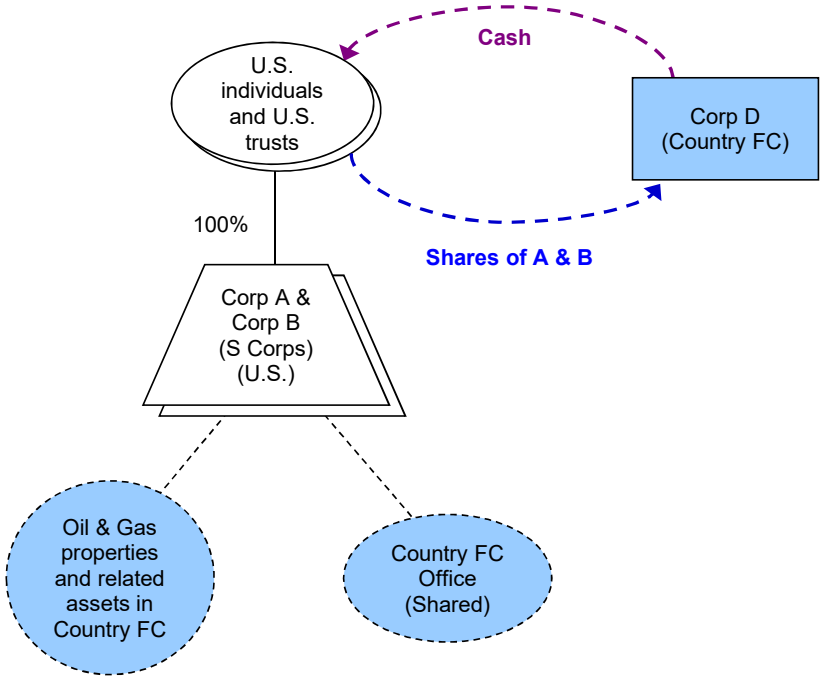
PLR 9612017

Gain on Sale of S Corporations Was Foreign Source Income



A and B are U.S. corporations that have elected under section 1362(a) to be treated as S corporations. A and B are engaged in the business of drilling and exploring for, and producing, oil and gas in FC. The assets of A and B consist entirely of oil and gas properties and related assets located in FC. A and B share an office in FC. The shareholders of A and B have entered into a Share Purchase Agreement with D, a publicly-traded corporation organized under the laws of FC. The Agreement provides that D will purchase all of the issued and outstanding shares of A and B.

Section 865 provides rules for determining the source of gain from the sale or disposition of personal property. Shares in a corporation are personal property. Section 865(e)(1) provides that in the case of income not sourced under subsection (b), (c), (d)(1)(B) or (3), or (f), if a U.S. resident maintains an office or other fixed place of business in a foreign country, income from sales of personal property attributable to such office or other fixed place of business shall be sourced outside the U.S. This rule, however, does not apply unless an income tax equal to at least 10% of the income from the sale is actually paid to a foreign country with respect to such income. The principles of section 864(c)(5) are applied in determining whether a taxpayer has an office or other fixed place of business outside the U.S. and whether a sale is attributable to such office or other fixed place of business.

Section 1373(a) provides that for purposes of subparts A (sections 901-907) and F (sections 951-964) of part III, and part V, of subchapter N (section 999), an S corporation is treated as a partnership, and the shareholders of such corporation are treated as partners of such partnership. The requested ruling involves the determination of the foreign tax credit limitation under section 904, which, in turn, requires a determination on the source of income from the transactions described in this letter ruling. Therefore, the S corporation can be treated as a partnership for purposes of determining the source of gain from the sale of stock in A and B under section 865(e)(1).

Section 865(i)(5) provides that, in the case of a partnership, section 865 shall apply at the partner level. The office or fixed place of business of a partnership is considered to be the office or fixed place of business of each of its partners. See Unger v. Commissioner, 936 F.2d 1316 (D.C. Cir. 1991); Donroy, Ltd. v. United States, 301 F.2d 200 (9th Cir. 1962). Because an S corporation is treated as a partnership pursuant to section 1373(a), the shareholders of A and B are considered to have an office or fixed place of business in FC through A and B.

The private letter ruling held that: (1) under the principles of section 864(c)(5), the entire gain on the sale of the shares in A and B is attributable to the foreign office or other fixed places of business of the shareholders of A and B; (2) if the shareholders of A and B actually pay to FC a 10% percent effective rate of income tax on the gain from the sale of their shares in A and B (computed by applying the principles of section 1.954-1) their share of the gain recognized on the sale of the A and B shares will be from sources outside the United States under section 865(e)(1); and (3) the gain recognized by the shareholders of A and B on the disposition of their shares in A and B will be treated as passive income for purposes of the section 904 limitation on the foreign tax credit, unless that gain qualifies as high-taxed income pursuant to section 904(d)(2)(F) and Treas. Reg. section 1.904-4(c).