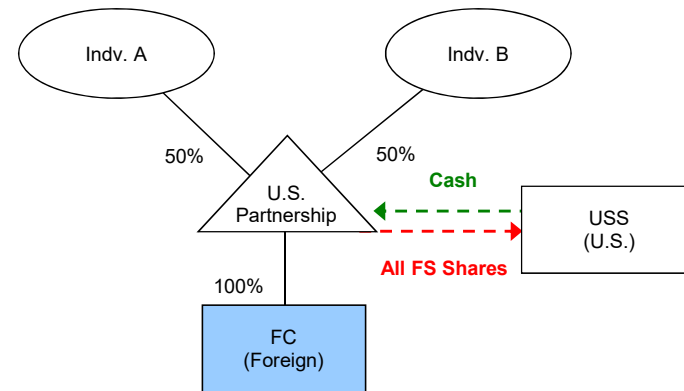


Revenue Ruling 69-124

Code §1248(b) Limitation Applies to CFC Stock Sold by Partnership

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FC Pre-Tax Income	100	
Foreign Taxes Paid by FC	(30)	
Earnings and Profits / §1248(a) amount	70	
Hypothetical U.S. Corporate Tax		
Domestic Corporate Pre-Tax Income	100	
U.S. Tax Imposed (35%) [§1248(b)(1)(A)]	35	
Less Foreign Taxes Paid / Foreign Tax Credits [§1248(b)(1)(B)]	(30)	
Hypothetical U.S. Corporate Tax [§1248(b)(1)]	5	
Hypothetical Shareholder Tax on Capital Gain		
§1248(a) amount	70	
Less Hypothetical U.S. Corporate Tax [§1248(b)(1)]	(5)	
Excess (Hypothetical Shareholder Capital Gain)	65	
Hypothetical Shareholder Tax on Gain (20%) [§1248(b)(2)]	13	
§1248(b) Limitation		
Hypothetical U.S. Corporate Tax [§1248(b)(1)]	5	
Hypothetical Shareholder Tax on Gain (20%) [§1248(b)(2)]	13	
§1248(b) Limitation	18	
U.S. Tax on §1248(a) amount without limitation (39.6%)	28	(Assumes non-treaty country)
U.S. Tax on §1248(a) amount with limitation	18	
U.S. Tax Savings as a result of §1248(b)	10	



The taxpayers, A and B, are individuals who are United States citizens and who are equal and the only partners in a domestic partnership. The partnership owned all of the stock of a foreign corporation ("FC"). FC was a controlled foreign corporation within the meaning of Code §957. Subsequently, the partnership sold its stock in the corporation, realizing a long-term capital gain. By reason of Code §1248(a), the partnership (which is a United States person as defined in Code §7701(a)(30)) was required to treat such gain as a dividend. A and B, under the provisions of Code §702, included in their gross incomes as a dividend their distributive shares of the gain from the sale of the stock.

The IRS held that the tax attributable to the amounts included by A and B in their gross incomes as a dividend is subject to Code §1248(b) which, in the case of individuals, provides a limitation on the amount of tax attributable to amounts included in gross income as a dividend. For purposes of the calculation above, the following is assumed: the U.S. partnership has owned 100% of FC's stock since its date of incorporation; FC is not located in a country that is a party to a comprehensive income tax treaty with the U.S.; and FC has not made any distributions, nor has the U.S. partnership had any Code §951 inclusions ("Subpart F Income") related to FC.

On the date of sale, FC has accumulated earnings and profits of \$70. The partnership's gain on the sale of FC stock is greater than \$70. Consequently, the partnership is required to recharacterize \$70 of the gain as dividend income under Code §1248(a). For simplicity, it is assumed that FC was subject to a flat foreign tax rate of 30%, and FC would have been subject to a flat 35% tax rate in the U.S. (had it been a U.S. corporation). It is further assumed that Individual A and B would be subject to a 39.6% tax on dividend income from FC and would be subject to a 20% tax on capital gains related to FC stock. The U.S. tax on the Code §1248(a) amount is limited to \$18 pursuant to Code §1248(b). A and B must include in gross income as a dividend their distributive shares (50%) of the Code §1248(a) amount and the gain not recharacterized as a dividend under Code §1248(a). The Net Investment Income Tax (3.8%) of Code §1411 may also apply.

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