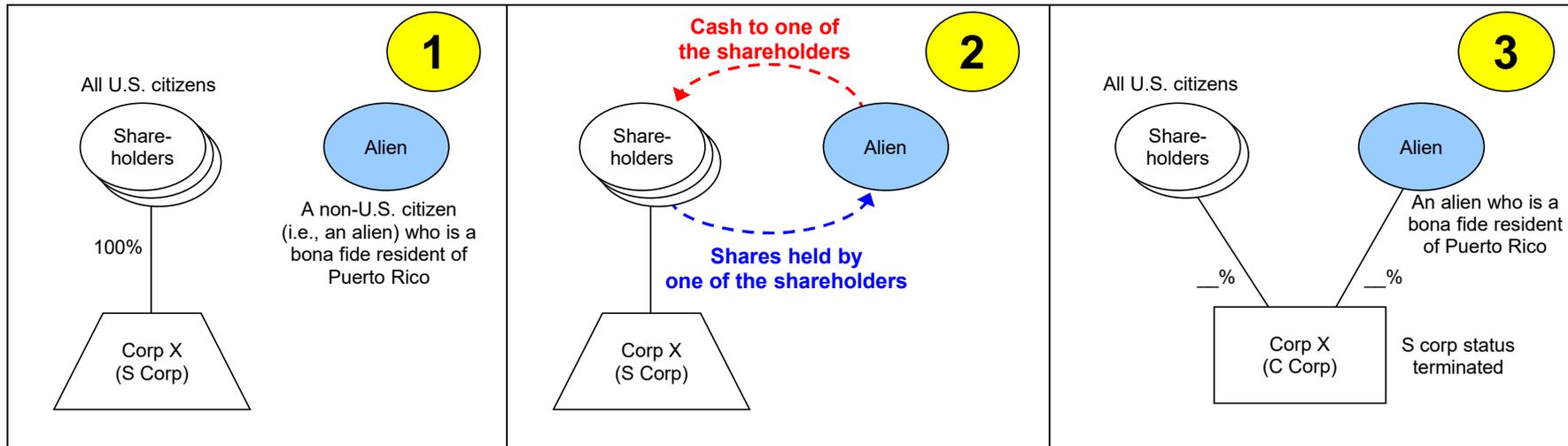


**Sale of S Corp Stock to an Alien
BFR of PR Terminates S Election**

Initial Structure

Sale of Shares

Ending Point



X is a domestic corporation organized in 1971. On June 1, 1972, the shareholders of X, who are United States citizens, filed a valid election under the provisions of section 1372. One of the shareholders subsequently sold his shares in X to a resident of Puerto Rico who is not a citizen of the United States.

Alien individuals are divided generally into two classes, namely, resident aliens and nonresident aliens. Reg. 1.871-2 provides, in part, that the term “nonresident alien individual” means an individual who is not a citizen of the United States and whose residence is not within the United States. (now see Section 7701(b))

Section 7701(a)(9) provides that the term “United States” when used in a geographical sense includes only the States and the District of Columbia. Where, for purposes of Federal income tax, a question is raised whether an individual is a resident of the United States, the term “United States” is used in a geographical sense.

Section 876 provides, in effect, that an alien individual who is a bona fide resident of Puerto Rico during the entire taxable year is subject to tax in the same manner as a resident alien (and a United States citizen) under section 1 rather than as a nonresident alien. Even though an alien resident in Puerto Rico may be subject to Federal income tax at the rates applicable to a United States citizen or resident alien, he is still treated as a nonresident alien.

Accordingly, the sale of shares in X to an alien individual, who is a resident of Puerto Rico, terminates the election under section 1372.