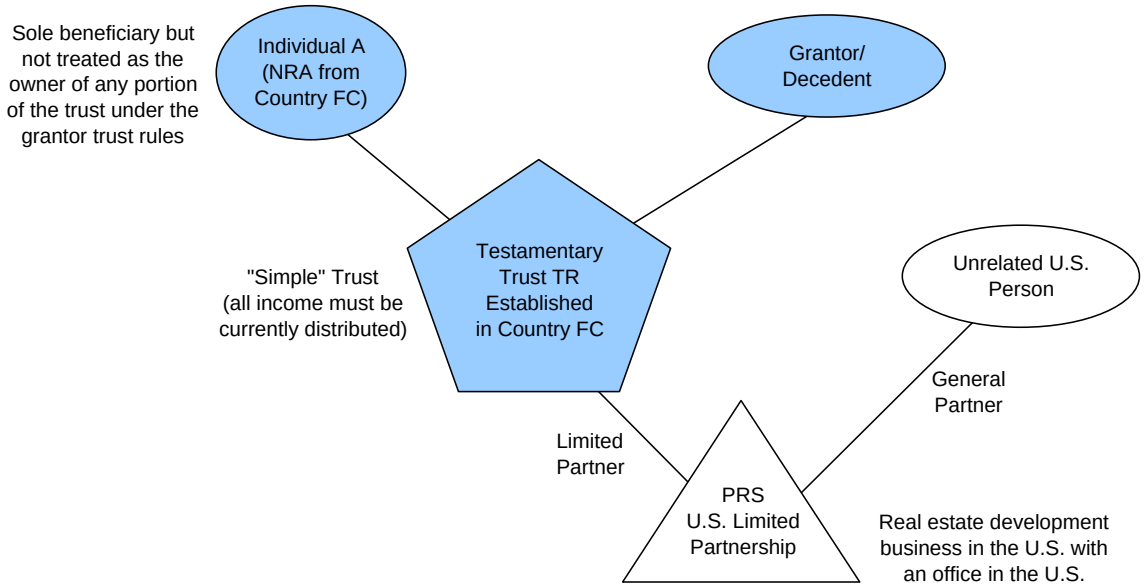
Revenue Ruling 85-60

Foreign "Simple" Trust as a Partner in a U.S. Partnership



A is a citizen and resident of a foreign country (FC). A is the sole beneficiary of TR, a testamentary trust established in FC for the benefit of A. A is not treated as the owner of any portion of the trust under the grantor trust rules. Pursuant to the trust instrument, TR became a limited partner in PRS solely for the purpose of protecting and conserving the assets of the trust for A. PRS, a limited partnership formed in the United States, is engaged in the real estate development business in State S and maintains a business office there. TR derives some of its income from the limited partnership interest in PRS. TR is required by the trust instrument to currently distribute all of its income to A, which TR does. Section 871(b) provides that a nonresident alien individual engaged in a trade or business within the U.S. shall be taxable on income that is effectively connected with the conduct of a trade or business within the U.S. Article VI(1) of the Income Tax Treaty between the U.S. and FC (Treaty) provides that industrial or commercial profits of a resident of FC shall be exempt from tax by the U.S. unless such resident is engaged in industrial or commercial activity in the U.S. through a permanent establishment ("PE") situated therein. Article VII of the Treaty provides that the term "permanent establishment" means a fixed place of business through which a resident of FC engages in industrial or commercial activity. The term "fixed place of business" includes an office. PRS has an office in the United States. When a limited partnership conducts business activity in the U.S. through a fixed place of business (such as an office), the office of the limited partnership is a permanent establishment in the U.S. with regard to each limited partner. Donroy, Ltd. v. United States, 301 F.2d 200 (9th Cir. 1962), Johnston v. Commissioner, 24 T.C. 920 (1955). Therefore, the office of PRS is a PE in the U.S. with respect to each partner, including TR.

Article II of the Treaty defines the term "industrial or commercial profits" as including income derived from real property. Accordingly, PRS has industrial or commercial profits. Because the amount of industrial or commercial profits will affect the income tax liability of TR or A, TR must take such item into account separately. See Reg. 1.702-1(a)(8)(ii). Generally, section 651(a) provides that a trust, the terms of which require it to distribute all of its income currently, shall be allowed a deduction in computing its taxable income in the amount of the income required to be distributed. Under section 651, TR will not owe any federal income tax. A, the beneficiary of TR, is subject to tax on the business profits of PRS that are passed through TR to A. Section 652(b) provides that income distributed from a trust described in section 651 shall have the same character in the hands of the beneficiary as in the hands of the trust. Neither the Treaty nor its legislative history contains specific rules as to whether a PE of a trust will be considered a PE of the beneficiaries. Consistent with the principles of section 652(b), the income resulting from the activities of PRS and distributed from TR to A will be treated in the hands of A as industrial or commercial profits attributable to a PE in the U.S.