Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **AM 2023-003**
Release Date: 5/19/2023

CC:INTL:B04:MMCahn
PGP-118150-20

UILC: 897.02-01

date: May 12, 2023

to: Orrin D. Byrd
(Director, Withholding, Exchange and International Individual Compliance)

from: Peter H. Blessing
Associate Chief Counsel (International)

---

subject: Application of Exception under section 897(c)(3) to Stock Held by Partnerships

This memorandum responds to your request for generic legal advice. This advice may not be used or cited as precedent.

FACTS AND ISSUE

In each of the following situations, PRS is a partnership[1] in which each partner is allocated a proportionate share of all items of PRS's income and loss in accordance with its partnership agreement. CORP, a domestic corporation, is a United States real property holding corporation ("USRPHC"), within the meaning of section 897(c)(2), at all times during the relevant holding period and has a single class of stock outstanding. CORP's stock is regularly traded on an established securities market within the meaning of section 897(c)(3). NRA, a nonresident alien individual, owns a 25 percent interest in the capital and profits of PRS. The other partners of PRS are United States citizens, unrelated to NRA.

Situation 1: PRS holds eight percent of the outstanding stock of CORP. NRA owns no stock of CORP, directly or constructively, aside from its ownership of CORP stock through its interest in PRS. PRS disposes of all of its CORP stock. Gain is recognized

---

[1] The partnership is not a qualified shareholder as defined in section 897(k)(3). All references to "Section" or the "Code" in this document refer to the Internal Revenue Code of 1986, as amended.

on the disposition of the CORP stock and is allocated proportionately to each of PRS's partners, including NRA.

Situation 2: PRS holds four percent of the outstanding stock of CORP. In addition to the ownership of CORP stock that NRA holds through its interest in PRS, NRA directly holds 4.5 percent of the outstanding stock of CORP. NRA disposes of, and recognizes gain on, all of the CORP stock that it holds directly.

You have asked whether, in each situation, NRA's gain on disposition of CORP stock is treated as effectively connected income under section 897(a).

LAW

Section 897 was enacted in 1980 as part of the Foreign Investment in Real Property Tax Act ("FIRPTA").[2]

Section 897(a)(1) provides that gain or loss of a nonresident alien individual or a foreign corporation from the disposition of a United States real property interest ("USRPI") shall be taken into account as if the taxpayer were engaged in a trade or business within the United States during the taxable year, and as if such gain or loss were effectively connected with such trade or business under section 871(b)(1) in the case of a nonresident alien individual and under section 882(a)(1) in the case of a foreign corporation.

Section 897(c)(1)(A) generally provides that the term USRPI includes any interest (other than an interest solely as a creditor) in any domestic corporation unless the taxpayer establishes that such corporation was at no time a USRPHC during the shorter of the period after June 18, 1980, during which the taxpayer held such interest, or the 5-year period ending on the date of the disposition of such interest (the "relevant holding period").[3]

Section 897(c)(3) provides that if any class of stock of a corporation is regularly traded on an established securities market, stock of such class shall be treated as a USRPI only in the case of a person who, at some time during the relevant holding period, held more than 5 percent of such class of stock (the "regularly traded exception").[4]

Section 897(c)(6)(C) states that for purposes of determining under section 897(c)(3)

---

[2] Pub. L. No. 96-499, § 1122(a), 94 Stat. 2682 (1980).

[3] The term "USRPHC" is defined in section 897(c)(2) to mean any corporation if the fair market value of its USRPIs equals or exceeds 50 percent of the fair market value of its USRPIs, its interests in real property located outside the United States, plus any other of its assets used or held for use in a trade or business.

[4] For stock of a real estate investment trust, the threshold is 10 percent. *See* § 897(k)(1)(A). For simplicity, this memorandum will only refer to the 5 percent threshold.

whether any person holds more than 5 percent of any class of stock, section 318(a) shall apply (but by substituting “5 percent” for “50 percent” in section 318(a)(2)(C) and (a)(3)(C)). Section 318(a)(2)(A) provides that stock owned, directly or indirectly, by or for a partnership or estate shall be considered as owned proportionately by its partners or beneficiaries.

Although section 897(c)(3) does not provide its own definition of the term “person,” section 7701(a)(1) provides that the term “person” includes a partnership.[5] Accordingly, section 897(c)(3) should apply at the partnership level, unless it is more appropriate for the partnership to be treated as an aggregate of its partners for this purpose. Neither section 897 nor its legislative history addresses whether a partnership should be treated as an aggregate for this purpose.[6] As discussed below, treating a partnership as an entity separate from its partners is more appropriate in carrying out the purposes of section 897(c)(3).

Under an aggregate approach, the partners of a partnership, and not the partnership, are treated as owning the partnership's assets and conducting the partnership's operations. Under an entity approach, the partnership is respected as separate and distinct from its partners, and therefore the partnership, and not the partners, is treated as owning the partnership's assets and conducting the partnership's operations. Whether to treat a partnership as an aggregate or as an entity depends on the characterization that is more appropriate to carry out the purposes of the Code or regulatory provision at issue. *See* H.R. Rep. No. 83-2543, at 59 (1954) (Conf. Rep.).[7]

Under section 897(a), a foreign person that disposes of a USRPI is considered to be engaged in a trade or business within the United States and required to file related U.S.

---

[5] Treasury Reg. §1.897-9T(c) generally defines the term “foreign person” to mean a nonresident alien individual, a foreign corporation, a foreign partnership, a foreign trust or a foreign estate.

[6] *See* H.R. Rep. No. 96-1167, at 513 (1980) and H.R. Rep. No. 96-1479, at 187 (1980) (Conf. Rep.).

[7] *See also, e.g.,* REG-118250-20, 87 FR 3890-01 (January 25, 2022) (treating domestic partnerships as aggregates for purposes of section 1293 and 1295, since aggregate treatment is consistent with the general treatment of partnerships for purposes of the Passive Foreign Investment Company regime); REG-118775-06, 71 FR 34047 (June 13, 2006) (providing the 10-percent shareholder test under the portfolio interest regime is a partner level, *i.e.*, aggregate, determination due to the perceived policies of the provision); and TD 9008, 67 FR 48020 (July 23, 2002) (treating a partnership as either an aggregate or entity depending on the specific purpose of a particular subpart F provision); *Holiday Village Shopping Center v. United States*, 5 Cl. Ct. 566, 570 (1984), aff'd 773 F.2d 276 (Fed. Cir. 1985) (“[T]he proper inquiry is not whether a partnership is an entity or an aggregate for purposes of applying the internal revenue laws generally, but rather which is the more appropriate and more consistent with Congressional intent with respect to the operation of the particular provision of the Internal Revenue Code at issue.”); *Casel v. Commissioner*, 79 T.C. 424, 433 (1982) (“When the 1954 Code was adopted by Congress, the conference report . . . clearly stated that whether an aggregate or entity theory of partnerships should be applied to a particular Code section depends upon which theory is more appropriate to such section.”).

tax returns. Since stock of a domestic USRPHC generally[8] is a USRPI, but for the regularly traded exception, foreign persons will have a filing requirement if they dispose of regularly traded stock of a domestic corporation that was a USRPHC during the relevant holding period.[9]

Generally speaking,[10] section 897(c)(3) allows a foreign person to trade in stock of a corporation having a class of stock regularly traded on an established securities market, without a filing requirement, if the foreign person did not hold more than 5 percent of the class of stock (or, in the case of a non-regularly traded class of interests, an amount of such class not exceeding in value 5 percent of a regularly traded class) at any time during the relevant holding period.[11] In addition, the enactment of section 897(c)(3) relieved a foreign person in such circumstances from the need to determine whether the corporation is a USRPHC.

Whether a partnership should be treated as an entity or aggregate for this purpose may be informed by the treatment of partnerships in other contexts where, as here, the question is whether a partner's share of a partnership's income is subject to U.S. tax based on nexus. In those other contexts, nexus is determined at the partnership level, taking into account the partnership's activities. For example, when a foreign person invests through a partnership that engages in a trade or business in the United States, the trade or business is imputed to the foreign person, and the foreign person is required to file U.S. tax returns. This is the case regardless of the relative ownership interest the foreign partner holds in the partnership. *See* section 875(1) and Treas. Reg. §1.6012-1(b)(1)(i). Similarly, in the case of a partner investing through a partnership, the applicability of the section 864(b) safe harbor is tested at the partnership level. *See* Treas. Reg. §1.864-2(c)(2)(ii) and -2(d)(2)(ii). A permanent establishment of the partnership is attributed to the partner for purposes of any applicable treaty.[12] Further, a tax-exempt entity may derive unrelated business taxable

---

[8] An exception may apply if the corporation is a qualified investment entity. *See* § 897(h)(2).

[9] *See* Treas. Reg. §1.6012-1(b)(1)(i) (imposing a filing requirement on a nonresident alien engaging in trade or business in the United States) and Treas. Reg §1.6012-2(g)(1)(i) (imposing a filing requirement on a foreign corporation engaging in trade or business in the United States).

[10] The regularly traded exception is expressed separately in the regulations with respect to a class of stock that is regularly traded and a non-regularly traded class of interests in the corporation. *See* Treas. Reg. §1.897-1(c)(2)(iii); Treas. Reg. §1.897-9T.

[11] *Cf*. H.R. Rep No. 108-755 at 413 (2004) (American Jobs Creation Act of 2004 exempted foreign shareholders that hold 5 percent or less of regularly traded real estate investment trusts from the look-through provisions of section 897(h)(1) so that the foreign investor would not be required to file U.S. tax returns).

[12] *Unger v. Comm'r*, 936 F.2d 1316 (D.C. Cir. 1991).

income from a partnership in which the entity is a partner, whether or not publicly traded and regardless of the level of ownership.[13]

A partnership is a collective investment vehicle. The ability of such a vehicle to determine whether a corporation is a USRPHC is no more difficult than in the case of an individual or entity investing directly in the corporation. The requirement of partners to file returns in the case of a partnership exceeding the 5 percent threshold results from a choice to invest collectively and is consistent with the requirement to file returns which results from the principles of section 875 and other authorities.

Accordingly, if a partnership exceeds the 5 percent stock ownership threshold with respect to a corporation, stock of which is regularly traded on an established securities market, a foreign partner of the partnership is subject to tax on its allocable share of any gain from a sale of such stock, as the partner would be in the case of other effectively connected income.[14] Therefore, section 897(c)(3) applies at the partnership level when a partnership holds stock directly in a USRPHC.

CONCLUSIONS

In Situation 1, because PRS holds eight percent of the stock of CORP, the regularly traded exception does not apply. Therefore, the stock is considered a USRPI with respect to any foreign partner of PRS and, when PRS disposes of its stock of CORP, NRA is allocated its allocable share of the gain recognized on the disposition. Under section 897(a), NRA's gain on the disposition is effectively connected income.

In Situation 2, NRA holds 4.5 percent of the stock of CORP directly. Due to the section 318(a)(2)(A) attribution rules, NRA is also treated as holding NRA's proportionate share of stock held by PRS. Therefore, NRA is treated as indirectly owning an additional one percent of the stock of CORP (*i.e.*, 25 percent of PRS's four percent of the CORP stock). Because NRA is treated as holding a total of 5.5 percent of the stock of CORP under section 897(c)(3), when NRA disposes of its stock of CORP, the stock is considered a USRPI and NRA's gain recognized on the disposition is effectively connected income under section 897(a).

Please call Milton Cahn at (202) 317-4934 if you have any further questions.

[13] § 512(c)(1); H.R. Rep. No. 103-111 at 617 (1993).

[14] Treas. Reg. §1.897-1(c)(2)(iii)(A) states that the regularly traded exception applies only to a person who beneficially owns no more than 5 percent of the corporation's stock. The preamble to TD 7999, which promulgated Treas. Reg. §1.897-1, explains that use of the term "beneficially owned" was meant to exclude brokers and transfer agents from liability under section 897. See TD 7999, 49 FR 50689-01, 1985-1 CB 189. Treas. Reg. §1.1441-1(c)(6)(ii)(B) (treating the partner, rather than the partnership, as the beneficial owner of the partnership's *income* for withholding tax) is distinguishable because it deals with incidence of tax on income earned through a partnership rather than with determination of a threshold for nexus-based taxation.