DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR DISTRICT COUNSEL
CONNECTICUT-RHODE ISLAND DISTRICT
ATTN: GERALD A. THORPE, DISTRICT COUNSEL
CC:NER:CTR:HAR

FROM: Elizabeth G. Beck
Senior Technical Reviewer CC:INTL:BR6

SUBJECT:

This Field Service Advice responds to your memorandum dated November 17, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

LEGEND:

Amount A =
Amount B =
Amount C =
Amount D =
Amount E =
Amount F =
Amount G =
Amount H =

FSC1	=
Partner A	=
Partner B	=
Partnership A	=
Taxable Year 1	=
Taxable Year 2	=

ISSUES

1. Is a partnership with corporate partners treated as an entity or an aggregate for purposes of determining the fraction a FSC wholly-owned by the partnership should use in calculating the exempt portion (15/23 or 16/23) of its foreign trade income under the FSC administrative pricing rules of section 925?

2. Are the corporate partners of a partnership that wholly owns a FSC entitled to a dividends-received deduction pursuant to I.R.C. § 245(c)(1) in connection with their distributive shares of the dividends paid by the FSC to the partnership that are attributable to the FSC's foreign trade income?

CONCLUSIONS

1. A partnership with corporate partners should be treated as an aggregate for purposes of determining the fraction a FSC wholly owned by the partnership should use in calculating the exempt portion of its foreign trade income under the FSC administrative pricing rules of section 925. Therefore, in this case, the proper fraction for the calculation of exempt foreign trade income is 15/23, not 16/23 as claimed by taxpayer.

2. Yes. The corporate partners of a partnership owning a FSC are entitled to a dividends-received deduction pursuant to I.R.C. § 245(c)(1) in connection with their distributive shares of the dividends properly attributable to FSC foreign trade income determined under the administrative pricing rules and paid by the FSC to the partnership.

FACTS

FSC1, a foreign sales corporation ("FSC") under I.R.C. §§ 922 and 927, is wholly owned by Partnership A, a domestic partnership equally owned by Partner A and Partner B, which are unrelated domestic corporations. Partner A and Partner B are both accrual basis taxpayers. Partnership A files its U.S. income tax return (Form 1065) on a calendar year basis. Partner A also files its U.S. income tax return (Form 1120) on a calendar year basis. For the purposes of the present discussion, we assume there are no special allocations. Partner A's Taxable Year 1 and Taxable Year 2, which are at present under examination, correspond to the second and third taxable years of FSC1. FSC1 is a commission FSC and is not a shared FSC.

FSC1 and Partner A compute their taxable income from sales of export property using the administrative pricing rules in I.R.C. §§ 925(a) (1) and (2). We have not considered or addressed whether Partner A constitutes a "related supplier" within the meaning of Treas. Reg. § 1.927(d)-2T (i.e., whether Partner A is eligible to use the administrative pricing rules) and, if so, what the appropriate basis might be for computing taxable income under the administrative pricing rules.[1] For Taxable Year 1 and Taxable Year 2, FSC1 determined that for purposes of calculating the exempt portion of its foreign trade income (as defined in I.R.C. § 923(a)(1)) the appropriate fraction was 16/23. Accordingly, FSC1 reported the remaining amounts, $ Amount A and $ Amount B for Taxable Year 1 and Taxable Year 2, respectively, as nonexempt foreign trade income (i.e., the remaining portion of its foreign trade income) on its income tax returns (Forms 1120-FSC).

For Taxable Year 1 and Taxable Year 2, FSC1 paid cash dividends to Partnership A in the amounts of $ Amount G and $ Amount H, respectively. Partner A claimed a dividends-received deduction under I.R.C. § 245(c)(1)(A) equal to its share of the dividends on its Forms 1120 filed for Taxable Years 1 and 2. Examination does not know whether Partner B claimed similar tax treatment for its share of the dividends.

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[1] It appears that a portion, if not all, of the FSC income from sales of export property may not be determined under the administrative pricing rules of sections 925(a)(1) and (2) because FSC1 was not acting as a commission agent for a related supplier with regard to the sale. See I.R.C. § 925(a); Temp. Treas. Reg. §§ 1.925(a)-1T(b) and 1.927(d)-2T(a). As stated above, we have not considered or addressed this issue in this advice.

Examination determined that, for purposes of determining the appropriate FSC fraction, the partners of Partnership A should be considered FSC1's shareholders. As a result, Examination concluded that the appropriate fraction used to determine FSC1's exempt foreign trade income in these years was 15/23 (instead of 16/23) pursuant to I.R.C. § 291(a)(4). Accordingly, Examination computed FSC1's nonexempt foreign trade income for Taxable Years 1 and 2 to be $ Amount C and $ Amount D, respectively, a difference from the amount reported on FSC1's Forms 1120-FSC of $ Amount E and $ Amount F, respectively. Additionally, Examination proposes to "No Change" Partner's A claimed dividends-received deduction for Taxable Years 1 and 2.

LAW AND ANALYSIS

Issue 1.

A. The issue.

Where a foreign corporation qualifies as a FSC, its "exempt foreign trade income" is treated as foreign source income that is not effectively connected with the conduct of a trade or business within the United States and thus is not subject to U.S. income tax. I.R.C. § 921(a). A FSC's "foreign trade income" is its gross income attributable to foreign trading gross receipts and includes gross income from the sale, exchange, or other disposition of export property, and from the lease or rental of export property for use by the lessee outside the United States. I.R.C. §§ 923(b), 924(a)(1); Temp Treas. Reg. § 1.923-1T(a). "Exempt" foreign trade income (as defined in I.R.C. § 923(a)(1)) is a specific portion of overall foreign trade income, determined with reference to (1) the pricing method used to compute the FSC's income from the export transaction or group of export transactions and (2) ownership of FSC stock. I.R.C. §§ 291(a)(4), 923(a)(1), 923(a)(6); Temp Treas. Reg. § 1.923-1T(b).

Where, as in this case, a FSC determines its income using the administrative pricing rules under section 925(a)(1) or (2), either 15/23 or 16/23 of its foreign trade income may be treated as exempt. I.R.C. §§ 291(a)(4), 923(a)(1) and (3), 923(a)(6); Temp. Treas. Reg. § 1.923-1T(b)(1)(i).

More specifically, Temp Treas. Reg. § 1.923-1T(b)(1)(i) provides:

> If a FSC uses either of the two administrative pricing rules, provided for by section 925(a)(1) and (2), to determine its income from a transaction, or group of transactions, to which section 925 applies, (see § 1.925(a)-1T(b)(2)(ii) and (iii)), 15/23 of the foreign trade income that it earns from the transaction, or group of transactions, will be exempt foreign trade income. If a FSC has a non-corporate shareholder (shareholders), 16/23 of its foreign trade income attributable to the noncorporate shareholder's (shareholders') proportionate interest in the FSC will be exempt foreign trade income. See section 291(a)(4).[2]

Thus, the proper exemption percentage depends upon whether the FSC foreign trade income is attributable to noncorporate or corporate shareholders.

For the specific purposes of section 923(a)(1), the term "shareholder" is not defined in the Code, the FSC regulations, or case law. Nor is the term defined under section 291(a)(4), which is referenced by section 923(a)(6) for the "reduction in amount of exempt foreign trade income." Additionally, although the Code does not specifically provide the consequences when FSC stock is held by a partnership that has corporate partners, the legislative history, discussed below, indicates that the aggregate approach is more appropriate for this determination.

B. Partnership tax.

Partnership taxation is a mixture of provisions that treat the partnership as an aggregate of its members or as a separate entity. Under the aggregate approach, each partner is treated as the owner of an undivided interest in partnership assets and operations. Under the entity approach, the partnership is treated as a separate entity in which partners have no direct interest in partnership assets and operations.

The issue presented is whether a partnership with corporate partners that wholly owns a FSC should be treated as an aggregate so that its partners are

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[2] A similar rule applies where a FSC does not use the administrative pricing rules. See Temp. Treas. Reg. § 1.923-1T(b)(1)(ii) (where a FSC does not use the administrative pricing rules, 30% of its foreign trade income will be exempt foreign trade income; if such a FSC has a non-corporate shareholder (shareholders), 32% of its foreign trade income attributable to the non-corporate shareholder's (shareholders') proportionate interest in the FSC will be exempt foreign trade income).

considered to hold the FSC stock. If the answer is yes, then the FSC must take the corporate partners into consideration when determining the appropriate fraction to apply to its foreign trade income.

When Congress enacted Subchapter K, Congress stated as follows with respect to when the aggregate or entity approach should govern:

> No inference is intended, however, that a partnership is to be considered as a separate entity for the purpose of applying other provisions of the internal revenue laws if the concept of the partnership as a collection of individuals is more appropriate for such provisions.
>
> H.R. Conf. Rep. No. 2543, 83d Cong., 2d Sess. 59 (1954).

In line with this flexible standard, courts have recognized the appropriateness of the aggregate approach in certain circumstances. See, e.g., Casel v. Commissioner, 79 T.C. 424 (1982) (Treas. Reg. §§ 1.267-1(b)(1) and (2), which treats a partnership as an aggregate of individuals for purposes of I.R.C. § 267, upheld as a valid regulation); Unger v. Commissioner, T.C. Memo. 1990-15, aff'd, 936 F.2d 1316 (D.C. Cir. 1991) (aggregate theory applied to determine that Canadian partner had a permanent establishment in the United States by virtue of his interest in a U.S. limited partnership).

In Brown Group, Inc. v. Commissioner, 77 F.3d 217 (8th Cir. 1996), vacating and remanding 104 T.C. 105 (1995), the Tax Court held that the partnership entity should be ignored in characterizing a partner's earnings as taxable subpart F income. Brown Group involved a U.S. parent corporation (USP) with a Cayman Islands controlled foreign corporation (CFC) which was a partner in a Cayman Islands partnership (CIP). During 1985 and 1986, CIP earned commission income as a purchasing agent for USP. The issue turned on whether, under the "related person" test of subpart F, USP was a "related person" to the entity that earned the commission income, i.e., CIP. The Commissioner argued that the CFC's distributive share of CIP's commission income should be tested using an aggregate approach to determine whether it was subpart F income. In a revised opinion reviewed by the full Tax Court, the Tax Court agreed "substantially" with the Commissioner, stating that "[w]e believe that a close reading of the regulations under subpart F, a consideration of the structure and language of subchapter K (the partnership provisions), Congress' purpose in enacting subpart F, and certain language of § 954(d)(1) compel the result that [the Commissioner] advocates." On appeal, the Eighth Circuit overruled the Tax Court, adopting an entity approach. We disagree. See Notice 93-39, 1996-2 C.B. 209 (the Service does not agree with

Brown Group and intends to rely on principles and authorities under Subpart F and Subchapter K to apply an aggregate approach whereby subpart F income is generally is determined at the CFC partner level, including Treas. Reg. § 1.701-2(e) and (f) for periods for which it is effective). We believe the Tax Court's reviewed opinion is the correct approach and supports our conclusion in the present case.

With respect to the instant case, neither section 291(a)(4) nor section 923(a) prescribe the treatment of a partnership as an entity for purposes of those sections. To determine whether it is more appropriate to treat a partnership as an aggregate for purposes of these sections, it is therefore necessary to examine the purpose of those sections and the FSC regime as a whole.

C. FSC legislative history and other relevant guidance

As discussed below, the legislative history of section 923(a)(1) is intertwined with that of section 291(a)(4), which lists certain tax preference items upon which corporations pay a minimum amount of tax in addition to the corporation's regular tax. Prior to 1985, the tax was 15 percent of the corporation's tax preferences in excess of the greater of the regular income tax paid or $10,000. The history of section 923(a) is also linked to section 245, which provides rules concerning the treatment of dividends received by a domestic corporation from a foreign corporation.

In 1984, Congress enacted the FSC regime, effective for tax years beginning in 1985, as part of the Deficit Reduction Act of 1984. In the same Act, Congress, in light of large budget deficits, increased the tax on certain corporate tax preference items from 15 percent to 20 percent (or 5 percent) and amended the list of tax preferences. See Deficit Reduction Act of 1984, Pub. L. No. 98-369, §§ 68(b), 801(a); H.R. Con. Res. 328, 98th Cong., Div. A, at (28) (June 29, 1984); Staff of Senate Comm. on Finance, 98th Cong., 2d Sess., Explanation of Provisions Approved by the Committee on March 21, 1984, S. Prt. 98-169, Vol. I, at 192-194 (1984) (hereinafter Senate Finance Committee Explanation). The Senate Committee on Finance explained that:

> The bill will increase the 15-percent preference cutback to 20 percent. The benefits of the new FSC legislation in the bill will be reduced by 5/85 in the case of a corporate FSC shareholder. ...

> The provisions generally apply to taxable years beginning after December 31, 1984.

Senate Finance Committee Explanation, supra, at 194.

Thus, in enacting the FSC regime, Congress specifically coordinated the provisions of section 923(a)(1) with those of section 291(a)(4) in order to effectuate a cutback of FSC benefits to corporate shareholders.[3] In order to understand how the Senate Finance Committee determined the cutback would affect the FSC treatment of corporate shareholders, one must examine the overall FSC regime and, in particular, the treatment of dividends received from a foreign corporation under section 245.

Prior to the enactment of the FSC regime, section 245(a) provided that domestic corporations that received dividends from a foreign corporation were entitled to a deduction equal to 85 percent of the dividends received (subject to a cap), provided the foreign corporation was engaged in a trade or business in the United States and earned 50 percent or more of its income from sources effectively connected with the conduct of a trade or business for the 36 month period ending with the close of the foreign corporation's tax year in which the dividends were paid. In contrast, as part of the FSC regime, section 245 was amended to allow a 100-percent dividends-received deduction for earnings and profits from foreign trade income of a FSC where the administrative pricing rules were used. I.R.C. § 245(c). The general rule continued to apply to other FSC income. See Staff of Joint Comm. on Taxation, 98th Cong., General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984 (JCS-41-84), at 1059 (J.Comm. Print Dec. 31, 1984).

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[3] The final bill presented to the President for signature corrected the cut-back percentages in section 291(a)(4) to conform with the section 923(a) exempt foreign trade income percentages for corporate FSC shareholders. See H.R. Con. Res. 328, 98th Cong., Div. A, at (28) (June 29, 1984). Section 68(b) of the Deficit Reduction Act of 1984, as agreed by the Conference Committee on June 22, 1984 (H.R. Conf. Rep. No. 98-861, at 99 (June 23, 1984)) misidentified as 34% and 17/32, respectively, the percentages applicable under I.R.C. section 923(a) in determining exempt foreign trade income under non-administrative pricing and administrative pricing. In fact, section 923(a) provided that the exempt percentages were 32% and 16/23, respectively, for non-administrative pricing and administrative pricing. See H.R. Conf. Rep. No. 98-861, at 517 (June 23, 1984). As a result of this oversight, the intended substitution, and thus the cutback, would not have been achieved. H.R. Con. Res. 328 remedied the error by substituting the correct section 923(a) exempt percentages.

The Staff of the Joint Committee on Taxation summarized the FSC tax regime as follows:

> A domestic corporation will generally be allowed a 100 percent dividends-received deduction for amounts distributed from a FSC out of earnings and profits attributable to foreign trade income. Thus, there will be no corporate level tax on exempt foreign trade income and only a single-level corporate tax (at the FSC level) on foreign trade income other than exempt foreign trade income....
>
> To the extent a corporate shareholder of a FSC distributes dividends attributable to foreign trade income to its individual shareholders, the amounts will be taxed....
>
> A dividends-received deduction will not be allowed, however, for distributions attributable to other earnings and profits. These distributions will therefore be taxed currently to the shareholders, corporate or noncorporate, of the FSC.

Id. at 1059-1060. See also id. at 1042.[4]

Although the legislative history to the FSC regime does not address how the cutback is to operate when a FSC's stock is partially, or wholly owned by a partnership that has corporate partners, the treatment of S corporations owning FSC stock suggests that Congress intended to treat a pass-through entity as an aggregate for this purpose. The Senate Finance Committee report relating to the 1986 technical amendments clarifying the corporate preference cutback provisions states as follows:

> The Act, in extending this reduction of corporate preferences, sought to reduce the exempt portion of the foreign trade income of a FSC by

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[4] The General Explanation also states that in the case of a FSC having corporate and noncorporate shareholders, it is intended that principles similar to the current Domestic International Sales Corporation ("DISC") rules shall apply. Under the DISC rules, a DISC is not subject to income tax, but rather the shareholders of a DISC are subject to taxation on the earnings and profits of the DISC in accordance with the provision of chapter 1 [Income Taxes--Normal Taxes and Surtaxes] of the Code generally applicable to shareholders, as modified by the DISC provisions. I.R.C. §§ 991 and 995; Treas. Reg. §§ 1.991-1(a) and 1.995-1(a).

> 1/17 if the shareholder of the FSC is a corporation. The statute indicates that the cutback applies "with respect to" the corporate shareholder of the FSC. Congress intended that the cutback apply at the FSC level, which would reduce the portion of the FSC's foreign trade income that is exempt from tax at that level....

Staff of Senate Comm. on Finance, 99th Cong. 2d Sess, Tax Reform Act of 1986, S. Rep. No. 99-313, at 1053 (May 29, 1986). Furthermore, "the portion of foreign trade income that is exempt will be adjusted, under regulations, to take into account any shareholders that are not C corporations for whom there is no preference cutback." Id. at 1053-1054. Consequently, the FSC corporate preference cutback would not apply "when an S corporation is the shareholder." Id. Accordingly, Congress intended the 16/23 ratio to govern the calculation of the exempt portion of a FSC's income determined under the administrative pricing rules only to the extent the FSC's owners (direct or indirect) are not subject to the preference cutback.

Although nominally a corporation to which the cutback would apply, an S corporation generally does not face entity-level taxation but instead passes-through its tax items on a pro rata basis to its shareholders, who must be individuals or certain types of trusts or estates. I.R.C. §§ 1361, 1363, 1366; Treas. Reg. § 1.1361-1(f) (a corporation in which any shareholder is a corporation is not an S corporation). Thus, the cutback cannot apply to S corporation shareholders because these shareholders are not corporations but individuals, trusts, or estates. Under the same rationale, where a partnership is the sole shareholder of a FSC, the cutback should only apply to the extent dividends from the FSC are passing through the partnership to its corporate partners who are subject to the cutback. Therefore, the aggregate approach should govern application of sections 291(a)(4) and 923(a) for purposes of determining the appropriate fraction.[5]

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[5] Congress also made similar amendments to the FSC's predecessor regime, Domestic International Sales Corporations (DISCs), the provisions of which were largely adopted in the FSC regime. See Staff of Joint Comm. on Taxation, 98th Cong., General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984 (JCS-41-84), at 1043 (J.Comm. Print Dec. 31, 1984). More specifically, the deemed dividend distribution by a domestic international sales corporation (DISC) to a corporate shareholder (under section 995(b)(1)(F)(i)) was increased by 15 percent to 57½ percent of certain taxable income. This change had the effect of reducing the tax benefit from a DISC by 15 percent. Id. at 209.

Further support for adopting the aggregate approach in this context is found in Treas. Reg. § 1.922-1(f), which defines shareholder for purposes of the limitation on the number of FSC shareholders under section 922(a)(1)(B) and which adopts an aggregate approach. Treas. Reg. § 1.922-1(f), Q&A-6(v) provides:

> A partnership is not counted as a shareholder. A general or limited partner is counted as a shareholder if it is a corporation, an individual, or an estate, under the rules contained in subdivisions (i) through (iii). A general or limited partner is not counted as a shareholder if it is a partnership or a trust; the rules contained in subdivision (iv) and this subdivision (v) apply to the determination of who is counted as a shareholder.

(Emphasis added.)

Additionally, the aggregate approach is a more appropriate approach in the determination of a FSC's shareholders for purposes of sections 291(a)(4) and 923(a)(1) where a FSC's direct shareholder is a partnership because to conclude otherwise would allow the reduction of the corporate tax preferences involved here (section 291(a)(4)(B)) to be nullified by corporate taxpayers through the expedient of using a partnership as an ownership vehicle for a FSC.

Furthermore, the purposes of section 291(a)(4) and 923(a)(1) would be undermined if corporate taxpayers could manipulate the preference cutback to reach the inconsistent result of achieving more favorable treatment for corporate beneficiaries of FSC dividends than that received by similarly situated non-corporate distributees. In a scenario where Partnership A is not considered an aggregate, FSC1's exempt foreign trade income (as compared to a situation of direct ownership by Partner A and Partner B) would be increased by 4%; then, when the distributive share in the form of a dividend is included in the income of Partner A and Partner B, this increased portion of income would not be taxed to Partner A and Partner B, who enjoy a 100% dividends-received deduction pursuant to section 245(c)(1). If this additional 4% of exempt foreign trade income is passed-through to non-corporate distributees, for whom the dividends-received distribution is not available, it would be taxed dollar-for-dollar. Such a result is inconsistent with a reduction in corporate tax preferences and, accordingly, an aggregate approach is proper in this context.

Thus, in light of the purpose of section 291(a)(4) (*i.e.*, the cutback of corporate preference items and the FSC regime) we conclude that Partnership A, a partnership under U.S. law, should be treated as an aggregate of its members and its FSC1 stock considered to be owned directly by Partner A and Partner B in proportion to their respective interests in the partnership, for purposes of determining the proper ratio to use when calculating FSC1's exempt foreign trade income.

Issue 2

The primary issue is the effect of the dividends paid by FSC1 to Partnership A on Partner A's income tax liability for Taxable Years 1 and 2.

A domestic corporation is entitled to a 100% dividends-received deduction for dividends from a FSC that are distributed out of earnings and profits attributable to foreign trade income determined under the FSC administrative pricing rules. I.R.C. § 245(c)(1)(A).[6] In contrast, there is no provision in the Code that permits a dividends-received deduction for non-corporate entities or partnerships when computing their taxable income.

Under the rules of subchapter K, each partner's income tax is determined taking into account separately that partner's distributive share of the items listed in sections 702(a)(1) through (8). Subsection (a)(5) includes dividends with respect to which there is a deduction under part VIII of Subchapter B (which is titled "SPECIAL DEDUCTIONS FOR CORPORATIONS"). See Treas. Reg. § 1.702-1(a)(5). Subsection (a)(7) includes other items of income, gain, loss, deduction, or credit as shall be prescribed by regulations by the Secretary. See Treas. Reg. § 1.702-1(a)(8). Treas. Reg. § 1.702-1(a)(8)(ii) further specifies:

> Each partner must also take into account separately his distributive share of any partnership item which if separately taken into account by any partner would result in an income tax liability for that partner different from that which would result if that partner did not take the item into account separately.

The character of the items of income, gain, loss, deduction, or credit described in section 702(a)(1) through (8) and included in a partner's distributive share is determined as if each item were realized directly from the source from

[6] With respect to foreign trade income where non-administrative pricing is used, the dividend attributable to the exempt portion qualifies for the 100% dividends-received deduction for corporate recipients under section 245(c)(1)(A). For the nonexempt portion, see section 245(c)(2)(A).

which it was realized by the partnership, or incurred in the same manner as incurred by the partnership. I.R.C. § 702(b); Treas. Reg. § 1.702-1(b).

The dividends-received deduction under section 245(c)(1)(A) is contained in part VIII of Subchapter B. Accordingly, dividends received by Partnership A from FSC1 must be separately stated by the partnership pursuant to section 702(a)(5). Additionally, under the aforementioned rules, Partner A's tax liability is determined by treating its distributive share of FSC1 dividends as if Partner A had received these dividends directly from FSC1. As a result, Partner A is entitled to a 100% dividends-received deduction in connection with its share of the FSC1 dividends received through Partnership A.[7]

Support for this position is provided by Rev. Rul. 86-138, 1986-2 C.B. 84, which held that section 703(a) requires a subsidiary partnership in a multi-level structure to state separately items of income, gain, loss, deduction, and credit which if separately taken into account by any partner of any partnership in the structure would result in an income tax liability for the partner different than that which would result without such accounting. Like the limited partnership in Rev. Rul. 86-138, Partnership A is similarly required to state separately items of income, gain, loss, deduction, and credit which if separately taken into account by Partner A or Partner B would result in an income tax liability for the partner different from that which would result without such accounting. In the present case, such items would include FSC1 dividends qualifying for the section 245(c)(1)(A) dividends-received deduction as they affect the tax liability of Partner A and Partner B. The fact that FSC1 dividends flow through Partnership A does not change their character (*e.g.*, as "distributed out of earnings and profits attributable to foreign trade income for a period during which the other corporation was a FSC") and thus does not affect their deductibility to Partner A and Partner B.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Because we believe our discussion of Issue 1 resolves your question regarding the proper fraction to be used in the calculation of FSC1's exempt foreign trade income, this advice does not address your alternative approach of applying the partnership anti-abuse rule in Treas. Reg. § 1.701-2(b).

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[7] Although private letter rulings have no precedential value, this position is consistent with that taken in LTR 200009025 (Dec. 6, 1999).

Given that the appropriate fraction to be used in determining the exempt portion of FSC1's foreign trade income is 15/23 rather than 16/23, a separate adjustment should be made to FSC1's income tax returns for Taxable Years 1 and 2.

[redacted]

If you have any further questions, please call (202) 874-1490.

By: ______________________________
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