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KPMG report: Foreign partners: Tax Court rejects IRS's position in Rev. Rul. 91-32

A recent U.S. Tax Court case rejects the IRS's position in Rev. Rul. 91-32 that a foreign partner's capital gain from the sale of an interest in a partnership that is engaged in a U.S. trade or business is treated as gain that is effectively connected to a U.S. trade or business and therefore subject to U.S. federal income tax.

In [*Grecian Magnesite Mining, Co. v. Commissioner*](#) [PDF 200 KB], the Tax Court held that a foreign corporation was not subject to U.S. federal income tax on the gain that it realized upon the redemption of its interest in a U.S. domestic entity (LLC) treated as a partnership that was engaged in the conduct of a U.S. mining business (except to the extent that gain was attributable to the U.S. real property interests held by the LLC).

The case marks the first time that a court has addressed directly the IRS's controversial position in Rev. Rul. 91-32—that gain realized by a foreign person with respect to a disposition of a partnership interest is to be treated as effectively connected income to the extent that partnership assets are used or held for use in a U.S. trade or business.

KPMG initial analysis

The holding of Rev. Rul. 91-32 has been controversial since its issuance. Many commenters agree that the holding is correct from a policy perspective, but most question whether it is supported by existing law. For its part, the IRS has consistently maintained that the holding is correct under existing law and has in recent years added an item to its Priority Guidance Plan under section 864 "implementing Revenue

Ruling 91-32 relating to sales of certain partnership interests.”¹ In addition, the Obama Administration had proposed codifying the holding of the ruling as a revenue raiser in various budget proposals.

In this case of first impression, the Tax Court soundly rejected both the analysis as well as the holding of the revenue ruling. While the court’s opinion remains subject to appeal, it represents the Tax Court’s views and supports the position that, under most facts and circumstances, such gain is not subject to U.S. federal income tax solely as a result of the partnership being engaged in a U.S. trade or business.

Read a **July 2017 report** [PDF xx KB] prepared by KPMG LLP: *Foreign partners: Tax Court rejects the IRS’s position in Rev. Rul. 91-32*

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¹ See, e.g., 2016-2017 Priority Guidance Plan, (August 15, 2016).