



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

CC:INTL:Br1:Fleeman
PRENO-134644-02
October 21, 2002

MEMORANDUM FOR PAUL T. SHULTZ, DIRECTOR
EMPLOYEE PLANS, RULINGS AND AGREEMENTS
Attn: Larry Heben

FROM: W. Edward Williams, Jr.
Senior Technical Reviewer CC:INTL:Br1

SUBJECT: Request for Technical Assistance

This memorandum responds to your request for technical assistance dated June 10, 2002, with respect to a private letter ruling request filed on behalf of (the "Company"). Two of the rulings requested pertain to section 933 of the Internal Revenue Code (the "Code"), which is within the jurisdiction of CC:INTL.

FACTS

The Company is the sponsor of various employee benefit plans including the 401(k) Plan () and the

The is a profit-sharing plan with a cash or deferred arrangement under section 401(k) of the Code. It received a favorable determination letter from the . The also has received a favorable determination from the that it is qualified and its trust is exempt from Puerto Rico income taxation under section 1165(a) of the . We understand that the Company's representative will provide a representation that the trust is classified as a domestic trust under section 7701(a)(30)(E) and the regulations thereunder.

The is a profit-sharing plan with a cash or deferred arrangement. It is intended to qualify under , and it will be submitted to the for a determination as to its qualified status. No determination will be sought from the IRS with respect to the Participation in the is limited to employees of the Company or its affiliates who reside within the . We understand that the

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Company's representative will provide a representation that the trust forming part of the plan is classified as a foreign trust under section 7701(a)(31)(B) and the regulations thereunder.

As a result of the Company's acquisition of the _____ and its subsidiaries in the year _____ the Company assumed sponsorship of the _____ a profit-sharing plan with a cash or deferred arrangement that was qualified under section 401(a) of the Code and whose trust was exempt from taxation under section 501(a) of the Code. The _____ also had a determination letter from the _____ that it was qualified under the _____. We understand that the Company's representative will provide a representation that the trust forming part of the _____ was classified as a domestic trust under section 7701(a)(30)(E) and the regulations thereunder.

Effective July 1, 2001, the _____ Also effective July 1, 2001, the participants in the Plan who, _____ were performing services for the Company or its affiliates in the _____ became eligible to participate in the _____ and ceased to be eligible to receive any future contributions under the _____

The Company proposes to transfer the account balances of current and former employees of _____ or its affiliates who performed services entirely in the _____ during their respective terms of employment from the _____ This proposed transfer (the "Transfer") will occur via a trustee-to-trustee transfer directly between the trustee of the _____ and the trustee of the _____

The trust in which the assets will be held will be organized under the laws of the _____. Under section 1022(i)(1) of ERISA, the trust will be treated for purposes of section 501(a) as if it were an organization described in section 401(a). No election will be made under section 1022(i)(2) of ERISA to have the provisions of Title II of ERISA apply.

The Company represents that the _____ are and were bona fide residents of _____ during their term of employment with _____ or its affiliates and are also United States citizens.

The Company also represents that the employer contributions (excluding earnings and any employee after-tax contributions) credited to the account of any _____ prior to July 1, 2001 under the _____ as applicable,

relate to services performed entirely in the [redacted] In addition,
 employer contributions credited to the account of any [redacted] Participant under the
 on or following July 1, 2001 will relate to services performed entirely in
 the [redacted]

SECTION 933 RULINGS REQUESTED

You requested our assistance with respect to [redacted] fourth and fifth requests, which
 pertain to section 933:

4. That the portion of a distribution ("Distribution") from an account under
 the [redacted] that is attributable to any
 employer contributions credited under the [redacted] the
 [redacted] (excluding earnings and any employee
 after-tax contributions) is income derived from sources within [redacted] for
 purposes of Section 933 of the Code.

5. That the portion of a Distribution from an account under the [redacted]
 that is attributable to earnings on and
 accretions to employer and employee contributions is income derived from
 sources within [redacted] for purposes of Section 933 of the Code.

LAW AND ANALYSIS

Section 933(1) provides that in the case of an individual who is a bona fide resident of Puerto Rico during the entire taxable year, income derived from sources within Puerto Rico (other than amounts received for services performed as an employee of the United States or any agency thereof) is excluded from gross income and is exempt from tax under subtitle A of the Code, except that the individual is not allowed as a deduction from gross income any deductions (other than the deduction under section 151, relating to personal exemptions), or any credit properly allocable to or chargeable against amounts excluded from gross income under section 933(a).

Treasury Regulation § 1.863-6 provides that the principles applied for determining income from sources within and without the United States shall generally be applied for purposes of determining income from sources within and without a possession of the United States.

Sections 861 through 864 contain rules for sourcing income for services performed within and without the United States, but those sections contain no specific provision regarding the source of income from pensions.

Section 861(a)(3) provides that compensation for labor or personal services performed within the United States shall be treated as income from sources within the United States, and section 862(a)(3) provides that compensation for labor or personal services performed without the United States shall be treated as income from sources without the United States. Income from services performed partly within and partly without the United States is treated as derived partly from sources within and partly from sources without the United States. I.R.C. § 863(b).

Rev. Rul. 79-388, 1979-2 C.B. 270, describes the rules for determining the source of distributions from a private employer's qualified pension plan that is located in the United States and pays benefits to a retired nonresident alien individual who earned the right to the payments by performing services both within and without the United States. The ruling provides that such pension distributions must be allocated between U.S. and foreign source income as follows: (i) the portion of each distribution attributable to employer contributions with respect to services performed within the United States is income from U.S. sources; (ii) the portion of each distribution attributable to employer contributions with respect to services performed without the United States is income from foreign sources; and (iii) the portion of each distribution attributable to earnings on or accretions to employer contributions is income from U.S. sources.

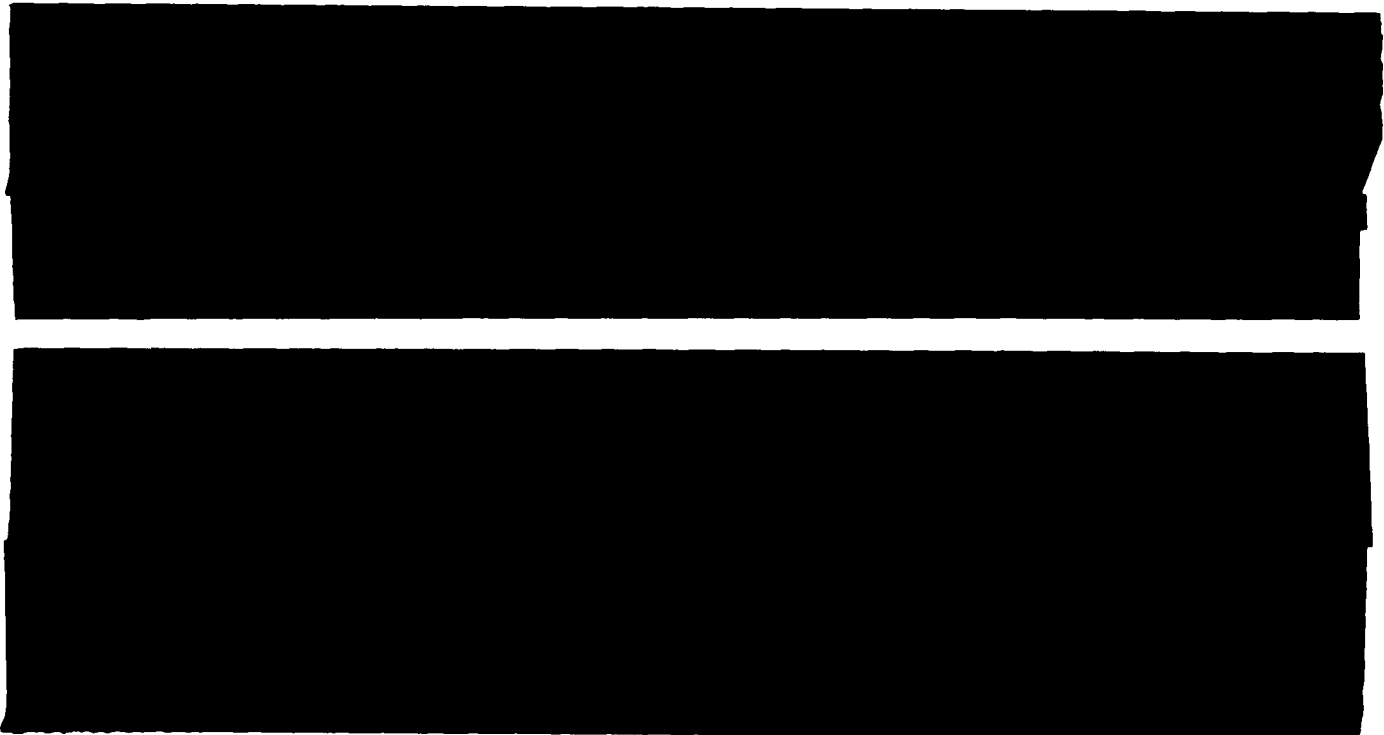
In Rev. Rul. 79-389, 1979-2 C.B. 281, the Service held for purposes of the section 904 limitation that the same allocation method applies to a United States citizen receiving pension distributions in respect of services performed partly within and partly without the United States.

The rationale for sourcing the earnings and accretions portion of the distribution in the United States was based, in part, on the legislative history of section 871(f) (pertaining to certain annuities paid to nonresident aliens under qualified plans), which states that in cases to which section 871(f) does not apply, a nonresident alien receiving pension income from a plan located in the United States is subject to United States tax on the interest portion of the pension income notwithstanding that employer contributions are wholly in respect of services performed abroad. 1979-2 C.B. at 271. In addition, the International Tax Counsel at the time the ruling was issued made a policy decision that a rule sourcing the earnings and accretions portion of the distribution on the basis of where the services were performed, instead of where the trust was sited, would "represent an unwarranted transmutation of a provision for tax deferral into one which unilaterally concedes primary tax jurisdiction on certain U.S. source income to foreign taxing authorities." G.C.M. 38007 (July 10, 1979).

The Court of Federal Claims upheld the Rev. Rul. 79-388 rule for sourcing the earnings and accretions portion of a distribution from a U.S. plan in Clayton v. United States, 33

Fed. Cl. 628 (1995), aff'd without published opinion, 91 F. 3d 170 (Fed. Cir.), cert. denied, 519 U.S. 1040 (1996).

Treas. Reg. § 1.401(a)-50(d) provides a special source rule for distributions to participants and beneficiaries residing outside the United States from a Puerto Rican trust that has made an election under section 1022(i)(2) of ERISA to be treated as a trust created or organized in the United States for purposes of section 401(a). The source of the portion of the distribution representing employer contributions is where the services giving rise to the contributions were performed. Treas. Reg. § 1.401(a)-50(d). The remaining portion, which represents earnings and accretions, is treated as income from sources without the United States. Id. A memorandum prepared at the time this regulation was being proposed stated that the determination of the source of distributions from an electing Puerto Rican plan corresponds to the determination of the source of distributions from a U.S. plan as described in G.C.M. 38007, Rev. Rul. 79-388, and Rev. Rul. 79-389. Memorandum from Jerome D. Sebastian, Acting Chief Counsel, by Jonathan P. Marget, Acting Director Employee Plans and Exempt Organizations Division, to Honorable Roscoe L. Egger, Jr., Commissioner of Internal Revenue (May 7, 1981), available in LEXIS (1981 TM LEXIS 50). The memorandum explained that the source of the earnings and accretions "should be that of the situs of the trust, and the situs of a trust under an electing plan is Puerto Rico." Id.





Ruling request 4

Ruling request 4 pertains to the source of the employer contribution portion of a Distribution from the

The Company has represented that all of the employer contributions credited to the account of any

relate to services performed entirely in the
Accordingly, under Rev. Rul. 79-388, the portion of a Distribution from an
account under the that is attributable to any
employer contributions credited under the
(excluding earnings and any employee after-tax contributions) will be
income from sources within for purposes of section 933.

Ruling request 5

Ruling request 5 pertains to the source of the earnings and accretions portion of a Distribution from the



Accordingly, if the Participants' account balances in the
Plan were to be distributed immediately to the Participants rather than
transferred to the Plan, the earnings and accretions portion of each
Distribution would constitute income from sources within the United States.





If you have any questions, please call