



TaxNewsFlash

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Source of gain under section 937 from certain dispositions of stock (IRS Chief Counsel memorandum)

The IRS issued Office of Chief Counsel memorandum* [AM 2024-005](#) (released December 17, 2024, and dated December 2, 2024) that addresses the source of gain under section 937 from certain dispositions of stock.

The memorandum examines a fact pattern in which a U.S. citizen (taxpayer) owns appreciated stock, which the taxpayer contributes to an S corporation in a section 351 exchange. The S corporation owns no other property, and the taxpayer is not a dealer in securities. Taxpayer subsequently becomes a bona fide Puerto Rico resident within the meaning of section 937(a). Two years thereafter, in Situation 1, the taxpayer sells shares of the S corporation for a gain, and in Situation 2, the S corporation sells the appreciated stock for a gain. The IRS concludes that:

- In Situation 1, the taxpayer's gain from selling the S corporation shares is not considered derived from sources within Puerto Rico, except to the extent: (1) the gain is attributable to the taxpayer's possession holding period, and (2) the taxpayer properly makes an election under Treas. Reg. § 1.937-2(f)(1)(vi). The conclusion would be the same if the only difference in facts were that the taxpayer became a bona fide resident of Puerto Rico before the S corporation was incorporated and elected to be an S corporation and before the taxpayer transferred the appreciated stock to the S corporation.
- In Situation 2, because an S corporation must be a U.S. resident, none of the taxpayer's pro rata share of the S corporation's gain from the sale of the appreciated stock is considered derived from sources within Puerto Rico. If the facts were the same except that a partnership, rather than an S corporation, sold the appreciated stock, the conclusion would be identical because the taxpayer's pro rata share of the partnership's gain from such sale would not be considered derived from sources within Puerto Rico under Treas. Reg. § 1.937-2(f)(1)(v).

*The IRS Office of Chief Counsel issues memoranda to IRS personnel who are national program executives and managers to assist them by providing authoritative legal opinions on certain matters, such as industry-wide issues. The memoranda cannot be used or cited as precedent.

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