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January 30, 2004

Legend

X =

Y =

Dear :

This refers to our letter to you dated May 5, 1993, in which we address the taxation of independent personal services income under Article 14 of the Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes, general effective date January 1, 1990, effective date for former German Democratic Republic, January 1, 1991 ("U.S.-Germany treaty").

Under the facts as originally submitted, X is a law firm organized as a partnership under the laws of the Federal Republic of Germany ("Germany"). Partnership has had a branch office in New York City since . Y, a partner in X, is a U.S. resident and represents X's New York office.

Y performs services for X solely in the United States. X and Y have executed an agreement that allocates all of the profits from the New York office to Y. Y filed U.S. income tax returns for , , and . German tax authorities informed Y that, because he does not perform services for X in Germany, he is only subject to tax in the United States.

X's New York branch office filed Form 1065 in , , and , which reports the operating results from the activities conducted at that office. The partners in X that were not U.S. residents during those years filed Form 1040NR.

Code section 701 states that a partnership as such is not subject to income tax; the persons carrying on the business of the partnership as partners are liable for income tax in their separate or individual capacities. Code section 702 requires a partner to determine his income tax by separately taking into account his distributive share of the partnership's income. Under section 702(b), the character of an item of income that is included in a partner's distributive share is determined based on how the item would be sourced, and the manner in which it would be incurred, if that item was realized directly by the partnership. Under Code section 704, a partner's distributive share is determined by the partnership agreement unless an allocation under the agreement does not have substantial economic effect.

Under section 875(1) of the Internal Revenue Code (the "Code"), a nonresident alien individual who is a partner in a partnership that is engaged in a U.S. trade or business is considered as being engaged in that U.S. trade or business. Under Code section 871(b)(1), a nonresident alien is taxable, as provided under Code sections 1 or 55, on his taxable income that is effectively connected with the conduct of a U.S. trade or business.

Section 894(a)(1) states that the provisions of the Code shall be applied to any taxpayer with due regard to any U.S. treaty obligation that applies to such taxpayer. Article 14 of the U.S.-Germany treaty applies to income derived by an individual from the performance of services in an independent capacity. Under Article 14(2), the term "personal services in an independent capacity" includes the independent activities of lawyers. According to the Treasury Department's Technical Explanation ("Technical Explanation"), Article 14(2) encompasses all personal services performed by an individual for his own account, whether as a sole proprietor or a partner, when that individual receives the income from, and bears the risk associated with, the services. Thus, Article 14 applies to income derived from the performance of independent personal services by partners in a service partnership.

Under Article 14(1) of the U.S.-Germany treaty, income derived by an individual who is a resident of a Contracting State from the performance of personal services in an independent capacity is taxable only in that State, unless the services are performed in the other Contracting State, and the income is attributable to a fixed base regularly available to the individual in that State for the purpose of performing his activities.

In our letter to you dated May 5, 1993, we concluded that, under Article 14 of the U.S.-Germany treaty, Y's distributive share of partnership income that is attributable to his performance of independent personal services at X's New York office is taxable

solely in the United States because Y only performed those services in the United States. We also concluded that German residents who are partners in X are not taxable in the United States on their distributive shares of partnership income, if any, attributable to Y's performance of independent personal services at X's New York office, because those partners did not perform any services in the United States.

After reconsideration, we have concluded that German residents who are partners in X are taxable in the United States on their distributable shares of partnership income, if any, attributable to Y's performance of independent personal services at X's New York office, without regard to whether those partners perform services in the United States.

Our private letter ruling, dated May 5, 1993, is revoked. Pursuant to the authority granted by section 7805(b) of the Code, this revocation will apply to the taxable year of X that begins after the date on which this ruling is issued.

This ruling is directed only to the taxpayer that requested the original ruling and its successors. Section 6110(k)(3) of the Code provides that it is not to be used or cited as precedent.

Sincerely,

Elizabeth U. Karzon
Chief, Branch 1
Office of the Associate Chief Counsel
(INTL)