



United States Tax Alert

Notice 2018-08 suspends withholding under Section 1446(f) on sales or dispositions of publicly traded partnership interests pending further guidance

On December 29, 2017, Treasury and the IRS issued Notice 2018-08 titled "Revised Timeline and Other Guidance Regarding the Implementation of New Section 1446(f)" (the Notice). The Notice suspends, until such time as future guidance is issued, all withholding on the sale or disposition of publicly traded partnership interests as defined under section 7704(b) (PTPs) otherwise imposed under newly enacted subsection 1446(f) in the tax law signed on December 22, 2017. Withholding on PTPs will be prospective from the date of the new guidance, which was issued in response to comments already made to Treasury and solicits additional specific and general comments. A revised timeline for implementing withholding on the disposition of PTP interests is also provided, but is subject to dates that must be provided in future guidance. The Notice does not suspend substantive treatment of foreign partner gains or losses as effectively connected income (ECI) under subsection 864(c)(8), also enacted in the new tax law, which is effective for sales or dispositions occurring on or after November 27, 2017. Finally, the Notice announces that the IRS continues to observe its position in Rev. Rul. 91-32 for non-PTP dispositions that occurred prior to November 27, 2017.

Background

New Internal Revenue Code subsection 864(c)(8) provides that the gain or loss from the sale or exchange by a foreign taxpayer of an interest in a partnership that was engaged in trade or business in the United States during the year is treated as effectively connected with a trade or business within the United States to the extent the foreign partner's distributive share of gain from a hypothetical sale of the partnership's assets would be treated as ECI. On its face, section 864(c)(8) applies to the sale or exchange of all types of partnership interests, including PTP interests. Section 864(c)(8) provides a coordination rule with section 897(g) to prevent double-counting of any outside gain or loss with respect to a partnership interest that is attributable to a foreign partner's distributive share that would be treated as ECI under the Foreign Investment in Real Property Tax Act (FIRPTA). The new statute authorizes regulations for the general purposes of the statute and to specifically address the treatment of dispositions made pursuant to nonrecognition provisions.

New Code subsection 1446(f) provides coordinating withholding requirements on the sale or disposition of partnership interests by foreign and undocumented US domestic taxpayers if any portion of the gain on the disposition would be treated as ECI under section 864(c)(8). When such conditions exist, section 1446(f) requires the transferee to withhold at a rate of 10% of the amount realized from the disposition. Where the transferee fails to withhold, the statute expressly provides that the partnership must withhold on its distributions to the new transferee partner, plus interest for the late withholding. The transferor's and transferee's agents are subject to the documentation requirements of section 1445(d), thus implicating brokers and other transfer agents in the withholding regime as well. Separate authorizations are granted for regulations concerning reduction of withholding to the extent such reduction does not jeopardize collection of tax on the ECI gain amount, and for the general purposes of the section, including situations where exceptions from the withholding requirements may apply. Old section 1446(f) is redesignated as new section 1446(g) and provides general authority to regulate for the purposes of section 1446(f), including the withholding treatment of PTPs.

Observation: Section 1446(f) does not require that PTP interests be granted exemption from withholding, but does have broad enough authorization for regulations to so provide. The statutory rule imposing withholding liability on partnership *distributions* when the transferee fails to withhold is analogous to a general rule already in Treas. Reg. §1.1446-4 that imposes withholding on ECI of a PTP only when the PTP makes distributions to its foreign shareholders. The inclusion of brokers and other transfer agents in the withholding regime implies broad application of the statute to all PTP dispositions by properly documented foreign taxpayers unless exceptions are provided in regulations or other guidance.

Notice 2018-08

Notice 2018-08 provides complete suspension of withholding under section 1446(f) on the transfer of PTPs as defined in section 7704(b). The Notice applies only to dispositions of PTP interests and does not apply to any non-PTP interest. The IRS announced that future guidance will provide rules on how to withhold, deposit and report tax on the disposition of PTP interests and will include transition rules to enable taxpayers to implement systems capable of compliance with the rules. The Notice also announces that withholding on PTP dispositions will be prospective with the future guidance.

In announcing its decision to suspend withholding under new section 1446(f) pending further guidance, the IRS announced the following

main considerations based on advance comments already aired by "stakeholders" with the government:

- Transferees of PTP interests, particularly PTPs held in street name by brokers that transfer through clearinghouses, often will be unable to identify whether the transferor is foreign or domestic.

Observation: Such withholding would essentially fall to the banks and broker-dealers that hold such PTPs, but implementing guidance is needed to determine whether, and the extent to which, the transferee and the partnership remain jointly and severally liable for failure to make foreign transferor determinations.

- Sales may be aggregated with other transactions of the same customer with the same broker, and determining the ECI treatment will likely require implementing broker-dealer systems changes for segregated transaction accounting.
- The IRS has solicited comments concerning situations where relaxation of withholding might also be appropriate for the disposition of non-PTP interests.

Additional Observation

Notice 2008-08 expresses the IRS's position that Rev. Rul. 91-32 continues to apply to non-PTP dispositions that occurred prior to November 27, 2017. This statement may indicate a forthcoming view that new section 864(c)(8) encompasses treating gain on the disposition of a partnership interest as attributable to a US office or other fixed place of business to the extent the partnership had one and to the extent a hypothetical distributive share of inside gain would have been so attributable. Such treatment has implications for the statute's consistency with existing US bilateral treaties and remains open for ambiguous interpretation pending further guidance.

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