1446(f): Withholding Tax on U.S. Partnerships Interests

Regulatory Overview and Timelines

Regulation Overview

Section 864(c)(8) specifies that a gain or loss by a foreign person on the sale or exchange of an interest in a partnership engaged in a U.S. trade or business is treated as an "effectively connected gain or loss" and, therefore, is subject to U.S. tax.

Section 1446(f) imposes the withholding requirement for Section 864(c)(8), and requires transferees (i.e., sellers) of an interest in a partnership to withhold 10% of the amount realized if any portion of the gain on the disposition would be treated under section 864(c)(8) as effectively connected with the conduct of a trade or business within the United States (unless an exception applies). The withholding tax applies to all sales of PTP shares along with distributions, such as dividends, from the PTP.

As the latest compliance date pertains to withholding under section 1446(f) on transfers of interests in publicly traded partnerships ("PTP interests"), this document will focus on these requirements.

Section 1446(f) Withholding Tax Exceptions

Qualified Notice exceptions are available along with documentation exceptions.

Qualified Notice (QN) Issued by the PTP no more than 92 days before the transfer:

- For Sales, QN issued to state that less than 10% of the total gain on the deemed sale of the PTP assets would be an "effectively connected gain" (the 10-percent exception) or that it is not engaged in a US trade or business
- For Distributions, QN issued to state that the distribution does not exceed the cumulative net income of the PTP since the date of the last distribution (the qualified current income exception)

The following are documentation exceptions that can be submitted to the broker/custodian to avoid the withholding tax:

- Certification of Non-Foreign Status (via Form W-9)
- Treaty claim made on W-8BEN (re: for individuals) and W-8BEN-E (re: for entities)
- W-8ECI with line 12 checked
- W-8IMY with withholding statement allocating gains to each partner to calculate a modified amount realized on the transfer (only for Full withholding Qualified Intermediaries)

Regulatory Timelines

As Section 1446(f) is the collection mechanism for Section 864(c)(8), the regulatory timelines for both rules is as follows:

Public Law 115-97 (2017)	1446(f) & 864(c)(8) added to the Internal Revenue Code by the Tax Cuts and Jobs Act	**December 22, 2017**
Notice 2018-08, 2018-7 I.R.B. 352	Withholding tax on PTP interests was temporarily suspended	**December 29, 2017**
Notice 2018-29, 2018-16 I.R.B. 495	Temporary guidance provided and intent announced to issue proposed regulations under section 1446(f)	**April 2, 2018**
84 FR 21198	Proposed regulations published under section 1446(f)	**May 13, 2019**
83 FR 66647	Proposed regulations published under section 864(c)(8)	**December 27, 2018**
Treasury Decision 9919	Final regulations issued under 864(c)(8) of the Code	**September 21, 2020**
Treasury Decision 9926	Final regulations issued under 1446 of the Code	**November 30, 2020**
Notice 2021-51, 2021-36 I.R.B. 361	Applicability date extended until Jan 1, 2023 for Section 1446(f) with respect to PTP Interests	**January 1, 2023**

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Withholding Agent Requirements and Indicative Example

Withholding Agent Responsibilities

Brokers and custodians that are acting on behalf of the seller are generally responsible for withholding the 10% tax under section 1446(f) for PTP share sales and distributions.

Brokers and Custodians making payment to a non-U.S. seller of in-scope PTP are required to withhold 10% of the gross proceeds of the sale, as well as 10% of distributions that are in excess of cumulative net income of the PTP, unless an exception applies. When applying the withholding tax the sales proceeds will be paid gross, with a corresponding debit equal to the Section 1446(f) withholding.

The Withholding Agent will be required to report the Section 1446(f) withholdings on Form 1042-S and submit the form to the IRS.

Key Considerations for Brokers in Preparing for Rule Compliance

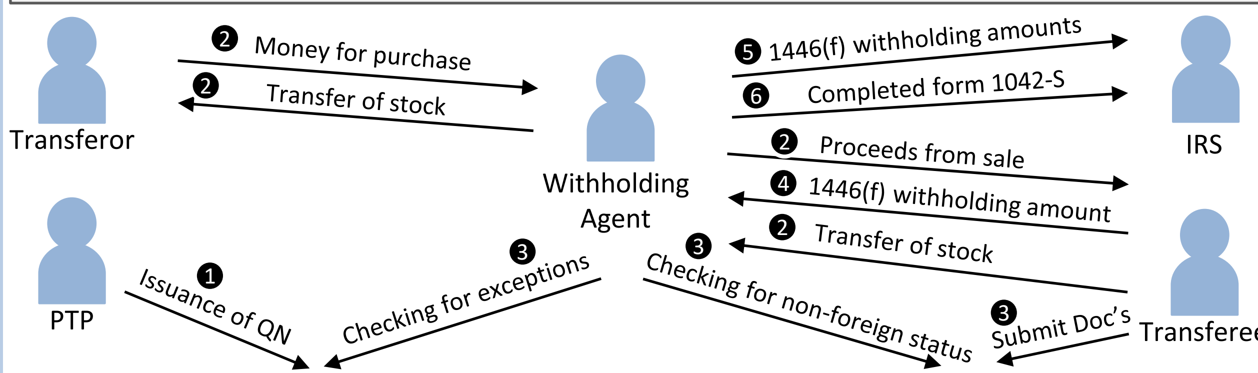
Brokers acting as Withholding Agents may choose to the following to prepare:

- Review holdings reports to determine which clients hold any PTP assets;
- Update U.S. Withholding Tax Documentation for clients intending on using exception to avoid withholding taxes by having a valid treaty claim;
- Review account structure of client accounts to check if it covers any new withholding rate pools or segregated account structure. For any account that is omnibus, the broker may choose to open a segregated account per beneficial owner holding only PTPs to support correct withholding, reporting and Schedule K-1 distribution;
- For Qualified Intermediaries and U.S. Persons acting as Withholding Agent, update reporting processes such as addition of Section 1446(f) withholdings on Form 1042-S;
- Update withholding processes to withhold amounts on PTP sales and distributions treated under section 864(c)(8) as “effectively connected gain”.

Illustrative Example of 1446(f) Withholding Tax Workflow

1. PTPs will issue Qualified Notices periodically which will serve as an exception to 1446(f);
2. Assume transferee sells its interest in PTP shares for a gain. Money is exchanged for the shares with the broker;
3. The Withholding Agent will check for exceptions available to see if 1446(f) withholding taxes are required for the sale;
4. Assume the Withholding Agent checks for QNs and treaty claims and confirms the transferee is a Foreign Person where 10% withholding is required.
5. Withholding Agent pays the IRS the amounts it has withheld for 1446(f)
6. Withholding Agent submits Form 1042-S to IRS

Assume a foreign person sells its interest in a Publicly Traded Partnership (PTP) through a Qualified Intermediary broker acting as a Withholding Agent for 1446(f). The following is the workflow of events:



PTP Qualified Notices Repository

PTP Claims on a Qualified Notice that an exception applies which are issued by the PTP no more than 92 days before the transfer

Beneficial Owner Account Documentation

- Form W-9 confirming non-foreign status
- Treaty Claim on W8-BEN/W8-BEN-E
- W8-ECI with Line 12 checked

IRC Section 1446(f)

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