

Final Regulation for Withholding on Transfers of Certain Partnership Interests: U.S. Internal Revenue Code (IRC) Section 1446

Considerations for Canadian institutional investors

DECEMBER 2020





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On October 7, 2020, the U.S. Treasury Department (Treasury) and the U.S. Internal Revenue Service (IRS) released final regulations under U.S. Internal Revenue Code (IRC) Section 1446(f) with respect to the withholding tax on a transfer by a non-U.S. person of an interest in a partnership that carries on a trade or business in the U.S. or otherwise realizes income effectively connected with such a trade or business (ECI).

The final regulations retain the overall approach and structure of the proposed regulations issued in May 2019, with certain revisions based on comments received.

Below is a summary of some of the key modifications:

WITHHOLDING BY PUBLIC TRADED PARTNERSHIPS (PTPS)

The final regulations require any broker that effects a transfer of a PTP interest on behalf of a foreign partner and receives the amount realized on behalf of the transferor must generally withhold a tax equal to 10 per cent of the amount realized, subject to certain exceptions.

The final regulations do not require a PTP withhold on a transferee, but instead add provisions imposing liability for under-withholding if the partnership issued an incorrect qualified notice upon which brokers relied to not perform the required withholding.

EXCEPTIONS TO WITHHOLDING

The final regulations generally adopt the framework of the proposed regulations, with certain modifications:

1

Certification of Non-Foreign Status – A broker may rely on a valid Form W-9 or a substitute certification for the transferor as a U.S. person.

2

10 Per Cent Exception – Withholding is not required if a qualified notice is provided by the PTP stating that the net gain that would be effectively connected gain in a hypothetical sale of the PTP's asset is less than 10 per cent of the total gain is retained.

3

No Qualified Current Income Distribution Exceptions – The final regulations entirely removed the proposed exception for withholding on qualified current income distributions by a PTP, and modified this rule to provide that a broker is only required to withhold on the portion of a distribution attributable to an amount in excess of cumulative net income, rather than current net income. The PTP would need to identify this portion on a qualified notice.

4

Proceeds Subject to Backup Withholding – The amount is subject to backup withholding.

5

Claim of Treaty Benefits – The transferor certifies that it is not subject to tax on any gain from the transfer by reason of an income tax treaty between the United States and a foreign country. A Form W-8BEN or W-8BEN-E, as applicable, may be used to make such certification.

6

ECI Exception – Withholding is not required if a valid Form W-8ECI is provided and certifies that the transferor is a dealer in securities, and that any gain from the transfer of a PTP interest is effectively connected with the conduct of a trade or business within the U.S. without regard to Section 864(c)(8).

7

Not Engaged in a Trade or Business Within the U.S. – Withholding is not required if the PTP provides in the qualified notice certifying that it is not engaged in a trade or business within the U.S. This notice must be posted by the PTP within the 92-day period ending on the date of the transfer.

QUALIFIED INTERMEDIARIES

The preamble of the final regulations confirm that Treasury and the IRS plan to update the Qualified Intermediary (QI) agreement (Revenue Procedure 2017-15) in order to allow QIs to assume primary withholding responsibilities on amounts realized under Section 1446(f) and on PTP distributions under Section 1446(a). The IRS stated that the provisions in these final regulations which are applicable to QIs will be incorporated into a revised QI agreement effective for the 2023 calendar year. Since the relevant provisions of the final regulations apply to QIs starting January 1, 2022, the IRS added that the requirements for QI related to Section 1446(a) and (f) for the 2022 calendar year will be set forth in a rider to the current QI agreement.

The final regulations allow a QI to assume primary withholding responsibility under Section 1446(f) on a payment-by-payment basis. In addition, a QI may assume (or not assume) primary withholding responsibility under Section 1446(f) on a sale of a PTP interest but not a distribution, and vice versa and under Section 1442. However, the final regulations require a QI that assumes withholding responsibilities on any portion of a distribution from a PTP to assume withholding responsibilities for the entire distribution, including when Section 1446(f) treats the distribution as a disposition. A QI that acts as a nominee under section 1446(a) for a distribution made by a PTP is required to assume all other required withholding responsibilities with respect to the distribution.

The final regulations provide that a broker determines the amount to withhold under Section 1446(f) on an amount realized and paid to a QI that does not assume primary withholding responsibility under Section 1446(f) based on aggregate information (i.e. in withholding rate pools) about account holders of the QI that are transferring PTP interests.

QIs may report withholding under Section 1446 on Form 1042-S on a pooled basis rather than issuing Forms 1042-S for each customer. The collective refund procedure, which allows QIs to obtain refunds of over-withholding on behalf of customers, will not be available for Section 1446 withholding.



The final regulations retain the overall approach and structure of the proposed regulations issued in May 2019, with certain revisions based on comments received.



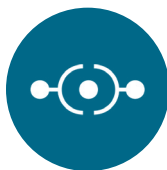
NON-QUALIFIED INTERMEDIARIES (NQIS)

The final regulations require a broker to withhold the full 10 per cent of the amount realized on transfers of PTP interest when paid to a NQI, even in situations where the NQI is acting on behalf of U.S. persons or foreign persons that are eligible for an exemption from withholding.



DOCUMENTATION OF NON-FOREIGN STATUS OF BROKER

The proposed regulations included a rule requiring a broker to treat another broker as a foreign person unless it obtains documentation (including a certification of non-foreign status, such as a Form W-9) establishing that the other broker is a U.S. person. The final regulations permit a broker to rely on documentation that it already possesses from the payee broker, rather than requiring new documentation for each transaction when the same payee broker is used.



BROKER'S DETERMINATION OF PRIOR BROKER WITHHOLDING

The proposed regulations included a rule under which a broker would not be required to withhold on an amount realized from the sale of a PTP interest when it knows that the withholding obligation has been satisfied by another broker. The final regulations allow a broker acting as an intermediary for an amount realized is not required to withhold when it receives the amount from another broker unless it knows, or has reason to know, that the paying broker did not withhold the full amount required.

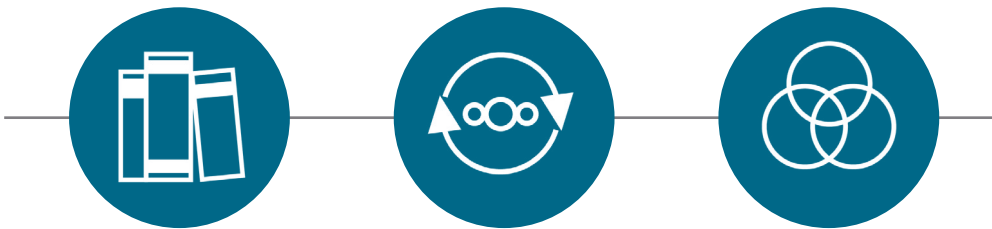
AMENDMENTS TO EXISTING SECTION 1446 REGULATIONS GOVERNING PTP DISTRIBUTIONS

The final regulations require a PTP to provide a qualified notice to any registered holder that is a nominee for a distribution. If a nominee cannot determine the status of a partner as a corporation, for purposes of the default withholding rule, the nominee is required to use the higher of the following rates: (1) the rate of withholding applicable to a foreign person that is a corporation, and (2) the rate of withholding applicable to a foreign person that is not a corporation, without regard to any available treaty reduction.

The final regulations allow a broker to withhold under Section 1446(a) based on specific payee documentation provided by a QI. The final regulations require a QI or U.S. branch that acts as a nominee under Section 1446(a) for a distribution made by a PTP to assume all other required withholding responsibilities with respect to the distribution.



The provisions in these final regulations relating to transfers of PTP interests generally will apply to transfers that occur on or after January 1, 2022.



EFFECTIVE DATES

The provisions in these final regulations relating to transfers of PTP interests generally will apply to transfers that occur on or after January 1, 2022. Similarly, the provisions in these regulations that are applicable to QIs will apply beginning January 1, 2022.

The different rules that apply to non-PTPs are beyond the scope of this article as brokers have no withholding or reporting obligations.

CIBC Mellon is not able to provide tax advice, and this document is provided for information purposes only in order to support clients as they consult their legal, tax and compliance advisors with respect to their specific obligations and duties. If you have questions regarding CIBC Mellon's role as an asset servicing provider, please do not hesitate to reach out to your relationship manager.



For more information

Please refer to the final regulations posted on the [IRS website](#) or contact your Relationship Executive, Service Director or Corporate Communications at corporate_communications@cibcmellon.com or call us at 416-643-5000.

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