

New Proposed Regulations for Withholding on Transfers of Certain Partnership Interests

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On May 7, 2019, the U.S. Treasury Department (Treasury) and the U.S. Internal Revenue Service (IRS) issued proposed regulations with guidance on how to apply withholding tax under U.S. Internal Revenue Code (IRC) Section 1446(f) 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). These proposed regulations are potentially relevant to any non-U.S. investor in such a partnership.

WITHHOLDING

Partners in publicly traded partnerships (PTPs) would most likely hold their interests through nominees such as brokers and custodians. The proposed regulations would require a tax equal to 10 per cent of the gross proceeds on any transfer of interest in such a PTP by a non-U.S. person to be withheld. Here, a transfer involves a sale, exchange, or other disposition of interest in a partnership. The seller broker that receives the gross proceeds from the transfer and acts on behalf of such a transferor would be required to withhold the tax.

The proposed regulations define a broker as any person, foreign or domestic, that in the ordinary course of a trade or business during the calendar year stands ready to effect sales made by others, and that, in connection with a transfer of a PTP interest, receives all or a portion of the amount realized on behalf of the transferor. Therefore, brokers, custodians and clearing organizations would likely be considered brokers under Section 1446(f).

When a foreign broker sells a PTP interest on behalf of its client, its U.S. brokers would be required to withhold 10 per cent tax unless (i) the foreign broker is a U.S. branch that has made an election to be treated as a U.S. person for U.S. withholding purposes, or (ii) the foreign broker is a "qualified intermediary" (QI) that assumes primary withholding responsibility. The proposed regulations state that the IRS would revise the QI agreement to permit QIs to do so.

For multiple brokers effecting a transfer of a PTP interest, they must treat another broker as a non-U.S. person and apply withholding. Unless, they obtain an IRS Form W-9 establishing that the other broker is a U.S. person. In addition, a broker is not required to withhold when they know that the withholding obligations has been satisfied by another broker.



EXCEPTIONS TO WITHHOLDING

The proposed regulations provide the following five exceptions to withholding that apply to the transfer of a PTP interest:

- Certifications 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 A qualified notice is posted online by the PTP stating that if on a hypothetical sale by the PTP of all of its assets at fair market value on a specified date, an amount of gain effectively connected with the conduct of a trade or business within the U.S. is less than 10 per cent of the total gain.
- **Qualified Current Income Distributions -** A qualified notice is posted online by the PTP indicating that the distribution does not exceed the net income it earned since the record date of the PTP's last distribution.
- **Proceeds Subject to Backup Wthholding -** The amount is already subject to Backup Withholding.
- Claim of Treaty Benefits The transferor has provided an IRS Form W-8-BEN or Form W-8BEN-E with the information necessary to support the claim.

The proposed regulations allow brokers to rely on a certification to modify the amount realized based on the extent to which the amount realized is attributable to persons who are (or are presumed to be) foreign persons.

A broker can rely on a qualified notice mentioned above if the notice has been posted by the PTP within a 92-day period ending on the transfer date. However, if a new notice is posted within a 10-day period ending on the transfer date, a broker can count on the immediately preceding notice.

PTP distributions would be subject to the highest withholding rate in Internal Revenue Code Sections 1441 (NRA withholding), 1442 (NRA withholding) or 1446 (withholding on transfer) unless a qualified notice provides the details to determine the types of income distributed and the appropriate withholding rates.

REPORTING AND PAYING WITHHELD AMOUNTS

A broker required to withhold tax under section 1.1446(f)-4 must remit the withholding tax and report the withholding on Forms 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, and 1042-S, Foreign Person's U.S. Source Income Subject to Withholding.

A transferor may have its substantive U.S. tax liability or filing obligation and is allowed a credit for the amount withheld. To claim the credit, the transferor must attach to its U.S. tax return a copy of Form 1042-S that includes its U.S. TIN. Therefore, transferors may wish to consider providing their U.S. TIN to their brokers before trading in PTPs.

EFFECTIVE DATES

The effective date of the new rules is generally 60 days after the proposed regulations are finalized, even though certain aspects of the new rules may be relied upon immediately. The different rules that apply to non-PTPs are beyond the scope of this article, as brokers have no withholding or reporting obligations.

For more information, please refer to the proposed regulations posted on the <u>U.S. federal register website</u>.

