

US IRS issues interim guidance under new Section 1446(f) for sales of interests in non-publicly traded partnerships

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Executive summary

In [Notice 2018-29](#) (the Notice), the United States (US) Internal Revenue Service (IRS) issued interim guidance under the new Internal Revenue Code¹ Section 1446(f) withholding rules for dispositions of interests in non-publicly traded partnerships (non-PTPs) that would generate gain treated as effectively connected with the conduct of a trade or business in the US (ECI) under Section 864(c)(8). The Notice generally does not suspend or delay the new Section 1446(f) withholding rules, which apply to sales, exchanges or dispositions of partnership interests occurring after 31 December 2017. The Notice suspends, however, a partnership's obligation to withhold when the transferee fails to withhold, and includes rules designed to facilitate implementation of Section 1446(f) and minimize overwithholding. The suspension of withholding for sales of interests in publicly traded partnerships (PTPs) under Notice 2018-8 remains in place.

Tax withheld under Section 1446(f) must be paid to the IRS and reported on IRS Forms 8288 (U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests) and 8288A (Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests) until other forms are issued for this purpose; the Notice provides special instructions for filing. Withholding tax generally must be paid and the forms filed within 20 days of the date of disposition. All withholding tax properly submitted by 31 May 2018, will be deemed to be timely paid and filed.

The Notice states that the IRS will not accept any application to obtain a certificate from the IRS to reduce or eliminate withholding until regulations are issued. However, interim self-certifications can be provided to relieve withholding in certain situations when withholding might exceed the transferee's ultimate tax liability. The Notice also clarifies that sellers of interests in partnerships may certify that they are US taxpayers that are exempt from withholding on IRS Form W-9 as well as on an affidavit of non-foreign status.

The 20-day withholding requirement gives rise to informational issues when a partnership makes distributions that may cause a partner to recognize gain, and partnership-level liabilities are includible in the amount realized on a disposition of a partnership interest. The Notice indicates that a partnership may rely on its books and records, or a certification received from the distributee partner, to determine whether a distribution exceeds a partner's basis in its partnership interest and, as such, whether withholding is required. The Notice also provides that the amount of withholding required does not exceed the selling partner's amount realized, less the selling partner's share of partnership liabilities (in order to ensure the amount required to be withheld does not exceed the cash proceeds).

Detailed discussion

Background

The *Tax Cuts and Jobs Act* (TCJA), P.L. 115-97, enacted on 22 December 2017, added new Section 864(c)(8), which treats the portion of gain (or loss) from the sale or exchange of an interest in a partnership that is engaged in a US trade or business as ECI to the extent the gain (or loss) from a hypothetical sale or exchange of the underlying assets held by the partnership would be treated as ECI allocable to the selling partner. This provision confirms the IRS's position under Revenue Ruling 91-32,² and prospectively overrules *Grecian Magnesite Mining, Industrial & Shipping Co. v. Commissioner*.³ New Section 864(c)(8) applies to sales, exchanges and dispositions on or after 27 November 2017. Foreign sellers of partnership interests must file US income tax returns to pay the new tax.

The TCJA also added new Section 1446(f), which requires the transferee of a partnership interest to withhold 10% of the amount realized on the sale, exchange or other disposition of the partnership interest "if any portion of the gain (if any)" would be taxable under Section 864(c)(8) unless the transferor partner provides an affidavit that it is not a

foreign person and provides a US taxpayer identification number (TIN). Under the statute, the amount required to be withheld could be reduced if the IRS agrees in advance to a reduced amount that "will not jeopardize the collection of tax." Section 1446(f)(4) provides that, if the transferee partner fails to withhold the full amount, the partnership must withhold on distributions to the transferor in an amount equal to the underwithholding, plus interest. New Section 1446(f) applies to sales, exchanges and dispositions of partnership interests occurring after 31 December 2017.

Because the effective date of Section 1446(f) was so soon after the date of enactment of the TCJA, the IRS issued Notice 2018-8 (the PTP Notice), which suspended withholding under Section 1446(f) (although *not* the substantive tax rule of Section 864(c)(8)) with respect to dispositions of interests in PTPs.

Notice 2018-29

The Notice includes guidance under Section 1446(f) relating to non-PTP interests. The Notice also reviews comments received in response to the PTP Notice. The Notice declines to suspend application of Section 1446(f) for non-PTP interests in all cases (as some commenters on the PTP Notice requested), but includes rules designed to facilitate implementation of Section 1446(f) and minimize overwithholding. The rules in the Notice that modify or suspend Section 1446(f) withholding do not affect the transferor's tax liability under Section 864(c)(8). The Notice also requests additional comments on several specific issues not previously raised in the PTP Notice.

Reporting and paying Section 1446(f) withholding for dispositions of non-PTP partnership interests

To address concerns about practical problems in applying Section 1446(f) to dispositions of non-PTP interests, section 5 of the Notice provides interim guidance on reporting and paying the amount required to be withheld under Section 1446(f)(1). Before the issuance of the Notice, transferees were obligated to withhold but there was no guidance on how the transferee was supposed to submit withholding payments to the IRS, resulting in the amounts being placed in escrow in many cases. As anticipated, until more tailored guidance is issued, the rules for withholding and paying over tax under the Notice are based on the *Foreign Investors in Real Property Tax Act* (FIRPTA) withholding rules of Section 1445. Thus, in accordance with Treas. Reg. Section 1.1445-1(c)(1), a transferee must report and pay

over the withheld amount by the 20th day following the date of the transfer. Transferees are instructed to use the current FIRPTA forms, Form 8288 and Form 8828-A, for both of these purposes, adding the statement, "Section 1446(f)(1) withholding" at the top of each.

Because Section 1446(f) applies for sales, exchanges and dispositions of partnership interests after 31 December 2017, and the Notice requires the reporting and payment to be made by the 20th day after the transfer, the Notice provides some relief for forms and payments that were due on or before 31 May 2018, in that such forms and payments will be deemed to be timely if submitted on or before 31 May 2018.

Certification of US status

Withholding is not required if the transferor furnishes an affidavit of non-foreign status to the transferee. Although there is a form of certification in Treas. Reg. Section 1.1445-2(b) that may be used, the Notice clarifies that the general certification of US person status, Form W-9, may also be used, provided that the form includes the name and US TIN of the transferor, is signed under penalties of perjury (without modification to the jurat), and is dated.

Relief from potential overwithholding

It is possible that the amount to be withheld under Section 1446(f) – 10% of the amount realized – will be exceed the tax ultimately due. There is a procedure under the FIRPTA rules of Section 1445 for taxpayers to demonstrate to the IRS that FIRPTA withholding will exceed the tax ultimately due, and obtain a certificate to withhold only a reduced amount (or nothing). Comments requested a similar procedure under Section 1446(f), but the Notice provides that the IRS will not issue such withholding certificates until further guidance is issued.

Instead, the Notice provides for certain self-certifications by the transferor or partnership, not filed with the IRS but provided to the transferee, on which a transferee may rely to reduce or eliminate withholding.

Certificate of no realized gain. Section 6.02 of the Notice provides that the transferee may refrain from withholding if the transferee receives a certificate in the prescribed form from the transferor, signed under penalties of perjury, stating that the transferee will realize no gain. The transferee may rely on the certificate absent knowledge that it is false. In this case, the Notice states that the transferee need not file Form 8288-A, but implies that the transferee must file

Form 8288. This procedure is not available when gain is realized in a transfer but not recognized as a result of a nonrecognition provision (in that case, the nonrecognition procedure described later applies).

Certificate of low ECTI. Section 6.04 of the Notice provides that the transferee may refrain from withholding if, no earlier than 30 days prior to the transfer, it receives a certificate in the prescribed form from the transferor, signed under penalties of perjury, which states: (1) for the three most recent complete years for which the transferor received Form 1065, Schedule K-1 and Form 8805 of the partnership,⁴ the transferor's allocable share of effectively connected taxable income (ECTI) was less than 25% of the transferor's total distributive share of taxable income for each of those three years; and (2) the transferor was a partner in the partnership for the entirety of each of those years. Again, the transferee may rely upon the certificate absent knowledge that it is false. This certificate may not be given if the transferor did not have a distributive share of income in any of those three preceding years during which the partnership generated ECI.

Certificate of low effectively connected gain. Section 6.04 also provides that the transferee may refrain from withholding if it receives a certificate in the prescribed form from the partnership, signed under penalties of perjury, stating that, if the partnership had sold all of its assets for fair market value, less than 25% of the gain would be ECI.

The Notice cautions that the IRS intends to reduce the 25% threshold in the last two certifications in future guidance.

Nonrecognition transfers

The Notice provides that the transferee need not withhold if it receives a notice from the transferor that the transfer will be a nonrecognition transaction. The procedures for the certificate are similar to those in Treas. Reg. Section 1.1445-2(d)(2).

Application to distributions in excess of basis

Under Section 731(a)(1), if a partner receives a distribution of money exceeding the partner's adjusted basis in its partnership interest, the partner recognizes gain, and the gain is considered gain from the sale or exchange of the partner's partnership interest. The Notice imports this concept into new Section 1446(f) by providing that Section 1446(f) applies to distributions to a partner exceeding the partner's adjusted basis in the partnership.

Partnerships may not know whether a distribution to its partners causes gain under Section 731(a)(1) as it is generally the partner's responsibility to track its adjusted basis in its partnership interest; the Section 1446(f) withholding rule, however, imposes the withholding obligation on the partnership. Section 9 of the Notice states that the partnership may rely on its books and records, or on a certification received from the distributee partner, to determine whether a distribution to a partner exceeds the partner's adjusted basis in its partnership interest, thus triggering a withholding obligation.

Impact of partnership liabilities

When a partner sells its interest in a partnership, its amount realized generally includes all or a portion of its allocable share of partnership liabilities.

To address concerns about when debt relief could cause the transferee to withhold an amount exceeding the amount paid to the transferor in cash or other property, section 8 of the Notice provides that the total amount of withholding is limited to the amount realized (as determined under Section 1001) less the decrease in the transferor's share of the partnership liabilities.

Section 7 of the Notice includes two rules for determining the amount of partnership liabilities that are included in the amount realized on the disposition of a partnership interest solely for purposes of determining the withholding obligation under Section 1446(f). If the transferor is not a "controlling partner," the transferee may include the amount of partnership liabilities reported on the transferor's most recent Schedule K-1 to determine the amount realized for purposes of Section 1446(f) withholding. For this purpose, a transferor is a controlling partner if the transferor (and related persons) owns a 50%-or-greater interest in partnership capital, profits, deductions or losses in the 12 months before the transfer. The transferee may not rely on the transferor's most recent Schedule K-1 if either: (1) the Schedule K-1 relates to a tax year that closed more than 10 months before the date of transfer, or (2) the transferor has knowledge of events occurring after the Schedule K-1 was issued that would cause the amount of the transferor's share of partnership liabilities at the time of the transfer to be "significantly different" than the amount reported on the Schedule K-1. A difference in the amount of the transferor's share of partnership liabilities of 25% or less is not a significant difference. Alternatively, a transferee may generally rely on a certification from the

partnership providing the amount of the transferor's share of partnership liabilities. This option is available regardless of whether a partner is controlling or non-controlling, and the partnership may also use the amount of liabilities reported on the transferor's most recent Schedule K-1, subject to same limitation regarding the partnership's knowledge of any events that would cause a significant difference in such amount.

Additional guidance

Section 10 of the Notice clarifies the interaction of Section 1445 and Section 1446(f), providing that, when both Section 1445 and 1446(f) apply to a disposition, the transferee's Section 1446(f) withholding and reporting obligations will generally be met if the transferee meets the withholding and reporting requirements of Section 1445.

Section 11 of the Notice suspends withholding on subsequent partnership distributions under Section 1446(f)(4) when the transferee fails to withhold (unless the partnership itself is the transferee). The suspension of withholding on sales of PTPs, announced in the PTP Notice, remains in place.

In section 12, the Notice announces that Treasury and the IRS intend to issue regulations clarifying guidance with respect to tiered partnerships.

Implications

The Notice provides much-needed guidance for dispositions of interests in partnerships other than PTPs, and outlines areas for which further comments are requested (such as the treatment of nonrecognition transactions under Section 864(c)(8)), indicating that taxpayer input will continue to help shape Section 1446(f) guidance as it develops.

Although some relief has been provided for sales occurring after 31 December 2017, and before the date of the Notice, the timetables provided in the Notice are very compressed. Going forward, reporting and payment will be required within 20 days of a disposition, and reporting and payment for prior sales occurring after 2017 must be completed by 31 May 2018, to avoid penalties and interest.

The Notice contains a presumption that any partner who does not provide a non-foreign affidavit is treated as foreign. As a result, the new regime affects partnerships regardless of whether the partnership has non-US partners and may cause administrative challenges for partnerships given the compressed timetables provided in the Notice.

The requirement to withhold tax on distributions exceeding basis may cause challenges for partnerships that are not constantly monitoring the adjusted basis their partners have in their partnership interests. The IRS acknowledged these difficulties, but the relief provided is limited. Given the 20-day requirement to which partners and partnerships are subject in determining whether withholding is required, some partnerships may consider amending their agreements to ensure all parties provide needed information quickly so that withholding requirements are met.

Unlike the rules for transfers of USRPIs, the Notice did not provide a mechanism to obtain certification from the IRS with respect to the withholding and reporting obligations under Section 1446(f). The Notice's provisions

for self-certification might not cover all cases in which withholding on 10% of the amount realized will exceed the ultimate tax due; because the TCJA was enacted so close to the end of 2017, however, it is understandable that the IRS needs more time to implement a withholding certificate system comparable to the Section 1445 regime. In addition, taxpayers will need to pay close attention to the requirements (such as the three-year rule for low ECTI certification), as well as the tight timeframe for providing the certifications. In the FIRPTA context, because so many self-certifications were not timely provided, in particular involving nonrecognition transactions, the IRS had to issue a reasonable cause procedure to accommodate late filings (Revenue Procedure 2008-27).

Endnotes

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.
2. 1991-1 C.B. 107.
3. 149 T.C. No. 3 (2017).
4. For example, a certification for a sale in 2018 would cover 2015, 2016 and 2017, but the certification could not be made until the transferor received these forms for 2017.

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