



Proposed regulations, withholding obligations incident to transfers of interests by foreign partners in partnerships engaged in U.S. trade or business

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The U.S. Treasury Department and IRS on Tuesday afternoon, May 7, 2019, released for publication in the Federal Register proposed regulations addressing withholding obligations incident to transfers of interests by foreign partners in partnerships that engage in a U.S. trade or business. The proposed regulations primarily are issued pursuant to authority contained in sections 864(c)(8) and 1446(f).

Read the text of the [proposed regulations](#) [PDF 476 KB] (116 pages) as published on the IRS webpage.

This report provides initial impressions and observations about these proposed regulations.

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Effective dates and reliance

The proposed regulations generally would apply to transfers beginning after the regulations are published as final regulations in the Federal Register (and in some cases, 60 days after such publication). Nevertheless, for certain transfers of partnership interests that occur prior to the finalization date of the final regulations, taxpayers are entitled to rely on either Notice 2018-08 or Notice 2018-29 or on certain provisions of the proposed regulations (provided that such regulations are applied in their entirety).

Notably, the proposed regulation provisions governing a partnership's secondary withholding obligation with respect to transferee partners and withholding on the transfer of a publicly traded partnership interest cannot be relied upon prior to finalization. These particular provisions are currently suspended under Notice 2018-08 and Notice 2018-29.

Overview

New section 864(c)(8) treats as effectively connected income a foreign partner's realized gain on the disposition of an interest in a partnership that is engaged in a U.S. trade or business. New section 1446(f)

imposes a withholding tax on transferees of such partnership interests. Section 1446(f)(6) provides the Treasury with authority to issue regulations to carry out the purposes of section 1446(f).

The Treasury Department and IRS previously released two notices that address section 1446(f):

- Notice 2018-08, 2018-7 I.R.B. 352 in which the Treasury Department and IRS suspended withholding requirements for interests in publicly traded partnerships; and
- Notice 2018-29, 2018-29 I.R.B. 495 in which the Treasury Department and IRS announced their intent to issue proposed regulations with respect to non-publicly traded partnerships.

Read [TaxNewsFlash](#) for KPMG's report on Notice 2018-29.

The Treasury Department and IRS also issued proposed regulations under section 864(c)(8) to assist taxpayers in computing a foreign partner's items of effectively connected income or loss upon a disposition of a partnership interest.

Read [TaxNewsFlash](#) for KPMG's report on the proposed regulations under section 864(c)(8).

Highlights of the proposed regulations

Partnership notification requirements

The proposed regulations would provide the framework for foreign persons disposing of an interest in a partnership to gather information needed from the partnership that will enable it to calculate its taxed owed under section 864(c)(8).

In particular, the proposed regulations would require foreign persons and certain domestic partnerships with foreign partners—each defined in the proposed rules as a “notifying transferor”—that transfer partnership interests (not including certain publicly traded partnerships) to notify the partnership within 30 days of the transfer. The notification is made in the form of a statement that includes the date of the transfer and other identifying information of the transferor and transferee.

A partnership receiving notice from a notifying transferor is required to provide the notifying transferor (or its designated agent) with the information needed to comply with section 864(c)(8) (i.e., the partnership's distributive shares of effectively connected items of income and loss) by the due date of the Schedule K-1 (Form 1065) for the tax year of the partnership in which the transfer occurred. Nevertheless, if the notifying partner would not otherwise have any items of effectively connected income or loss at the time of the transfer, the partnership is relieved of its disclosure requirement.

The information reported to the notifying transferor can be combined with the information that is already required to be reported under Treas. Reg. § 1.751-1(a)(3) (e.g., information needed for a partner to report the character of the gain on the sale of partnership interest).

Withholding on the transfer of a non-publicly traded partnership interest by a foreign person

Section 1446(f)(1) generally requires the transferee of a partnership interest to withhold a tax equal to 10% of the amount realized by the transferor when the disposition by the transferor results in gain that is treated

as effectively connected with the conduct of a U.S. trade or business under section 864(c)(8). The proposed regulations would provide rules for determining the amount of withholding, as well as several exceptions to section 1446(f)(1) withholding.

Amount of withholding by transferee

- *Amount realized:* The proposed regulations would provide that the amount realized by a transferor generally is determined under section 1001 and section 752. The proposed regulations would clarify that in the case of a distribution by a partnership to a partner, the amount realized by the partner is the sum of the cash distributed, the fair market value of other property distributed, and the reduction in the partner's share of partnership liabilities.
- *Dispositions by foreign partnerships:* Subject to certain documentation requirements, the proposed regulations generally would limit the amount subject to withholding to the portion of the amount realized that is attributable to direct or indirect foreign partners.
- *Withholding in excess of consideration transferred:* In situations where the amount of withholding would exceed the cash or property transferred by the transferee (e.g., because of the reduction in the transferor's share of partnership liabilities), the proposed regulations would limit the amount required to be withheld to the amount realized without regard to the decrease in the transferor's share of partnership liabilities.
- *Certification of maximum tax amount:* The proposed regulations would allow a transferee to withhold an amount equal to the transferor's maximum tax liability on the transfer if the transferee receives certain documentation from both the transferee and the transferred partnership establishing the amount of the transferor's gain.
- *Coordination with section 1445 withholding:* Consistent with Notice 2018-29, the proposed regulations generally would provide that if a transfer of a partnership interest is subject to withholding under both section 1445(e)(5) and section 1446(f)(1), that the transferee is required to withhold under section 1445(e)(5) only. However, if the transferor applies for a withholding certificate to reduce the transferee's section 1445 withholding obligation, the transferee must withhold the greater of the amounts required under section 1445(e)(5) or section 1446(f).
- *Reporting:* A partnership required to withhold under section 1446(f)(4) must report and pay the tax withheld using Forms 8288, *U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests*.
- *Transferor's non-resident income tax return filing requirement unaffected:* The withholding of tax under section 1446(f)(1) does not relieve a non-resident alien individual or foreign corporation subject to tax under section 864(c)(8) from its U.S. federal income tax return filing and payment obligation.

Exceptions to withholding

The proposed regulations would provide six exceptions to withholding by a transferee under section 1446(f)(1). The exceptions generally follow the categories of exceptions in Notice 2018-29, with certain modifications, and with one additional exception provided.

- *Certification of non-foreign status by transferor:* Consistent with Notice 2018-29, a transferee would not be required to withhold if the transferor certifies to the transferee that the transferor is not a foreign person. A Form W-9 may be used for this purpose.

- *No gain realized by the transferor:* Consistent with Notice 2018-29, a transferee would not be required to withhold if the transferor provides the transferee with a certification stating that the transferor would not realize any gain on the transfer of the partnership interest. The proposed regulations would make clear that this determination is to be made taking into account any ordinary income arising from the application of section 751(a) and the regulations thereunder.

KPMG observation

This provision typically would apply to a loss transaction. Note, however, that pursuant to section 751(a), a transferor of a partnership interest with an overall loss can result in ordinary gain under section 751(a) and a greater capital loss under section 741 which nets to the overall loss on the disposition of the interest.

- *Effectively connected gain upon a partnership's deemed sale:* A transferee would not be required to withhold if the transferee receives a certification from the partnership stating that if the partnership sold all of its assets at fair market value on the "determination date", the amount of net effectively connected gain resulting from the deemed sale would be less than 10% of the total net gain. Notice 2018-29 provides a similar exception, but at a 25% threshold and determined as of the date of transfer. A determination date can be (1) the date of the transfer; (2) any date no more than 60 days prior to the date of the transfer; (3) or the date that is the later of the first day of the partnership's tax year that includes the transfer or the most recent date prior to the transfer on which there was a revaluation event.

KPMG observation

The change by the IRS to certifying minimal ECI as of a determination date represents a practical approach to the partnership's ability to make such certification. As of any given transfer date a partnership may not have sufficient current-year information compiled to determine gain on a hypothetical sale as of that date, and the transferor partner's share of such gain. The ability for the partnership to rely on the prior year end information or information obtained on a revaluation event that may have caused the partnership to assess valuations is a practical approach to the ability to provide a certification at the time of a sale or exchange.

- *The three-year ECI exception:* A transferee generally would not be required to withhold if the transferee receives a certification from the transferor stating that the transferor was a partner in the partnership at all times during the prior three tax years and that the transferor's allocable share of the partnership's effectively connected taxable income for each of those tax years was less than 10% of the transferor's total distributive share of the partnership's net income for that year. Notice 2018-29 provides a similar exception, but at a 25% threshold. The proposed regulations also include several additional requirements not contained in Notice 2018-29.
- *Nonrecognition by transferor:* Consistent with Notice 2018-29, a transferee would not be required to withhold if the transferor certifies to the transferee that the transferor is not required to recognize gain or loss on the transfer pursuant to a nonrecognition provision. This certification requires the transferor to attach a statement to the certification that indicates the nonrecognition provision of the law that is applicable, a description of the transfer, and the relevant law and facts relating to the certification.

KPMG observation

A transferee is required to withhold on payments otherwise made to the transferor, subject to receiving a timely certification of exception. As such, to rely on the nonrecognition exception, the associated certification including the statement of law and application of facts to the law necessarily needs to be provided on that date as well, which may accelerate timing of advice to the transferor by its tax counsel and advisors. In addition, this provision does not apply if the nonrecognition provision only applies to a portion of the gain realized on the transfer.

- *Claim of treaty benefits:* A transferee would not be required to withhold if the transferor certifies that it is not subject to tax on any gain recognized on the transfer pursuant to an income tax treaty. Notice 2018-29 does not contain address the application of income tax treaties. This exception does not apply if only a portion of the gain from the transfer is subject to treaty exemption. Further, a transferee may only rely on this particular exception if it mails a copy of the certification received from the transferor, along with a statement of certain other identifying information, to the IRS within 30 days of the transfer.

KPMG observation

Satisfying the 30-day notice requirement of the treaty benefits certification is a significant diligence item that transferees should be aware of.

Treatment of liabilities in amount realized

A transferee of a partnership interest is required to withhold 10% of the amount realized by the transferor, which includes relief of the transferor partner's share of partnership liabilities. The proposed regulations provide that amount realized includes cash paid (or to be paid), the fair market value of property transferred (or to be transferred), the amount of liabilities assumed by the transferee or to which the partnership interest is transferred, and the reduction in the transferor's share of partnership liabilities.

To assist in determining a partner's share of liabilities for purposes of withholding, the proposed regulations provide two potential liability certifications:

- *Certification of liabilities by transferor:* A transferee would not be required to withhold if the transferor certifies its share of liabilities as reported on the most recent Schedule K-1 issued by the partnership, provided the tax year of the partnership for which the Schedule K-1 was issued is no more than 22 months before the transfer date. If the transferor's actual share of the liabilities at the time of the transfer differs from the liabilities on such Schedule K-1, the certification will be treated as incorrect or unreliable unless the transferor also certifies that it does not have actual knowledge of events that would cause its share of liabilities to differ by more than 25%. Notice 2018-29 contains a similar certification but the Schedule K-1 relied upon cannot relate to a partnership tax year that closed no more than 10 months prior to the transfer date. In addition, only transferors that are not controlling partners may use this certification. A controlling partner is one that, together with any related person, owns 50% or more in profits, losses or capital of the partnership.

KPMG observation

The extension of the tax year closing requirement from 10 months to 22 months by the IRS addressed not only a concern that a partner may not yet have received a final Schedule K-1 for such year by the date of transfer, but also addresses the result that transfers that occur in the

tenth, eleventh, or twelfth month following the close of the most recent tax year of the partnership would be ineligible for this certification.

- *Certification of liabilities by partnership:* A transferee would not be required to withhold if the partnership certifies its share of liabilities as of the determination date used for the transfer. If the transferor's actual share of the liabilities at the time of the transfer differs from the liabilities on such determination date, the certification will be treated as incorrect or unreliable unless the partnership also certifies that it does not have actual knowledge of events that would cause its share of liabilities to differ by more than 25%. The approach in the proposed regulations is different from that in Notice 2018-29. Notice 2018-29 contains a partnership certification that relies on the transferor's share of partnership liabilities reported on the most recent Schedule K-1 issued by the partnership, provided the tax year of the partnership for which the Schedule K-1 was issued is no more than 10 months before the transfer date.

KPMG observation

The approach of the proposed regulations recognizes that a partnership has access to the information necessary to more precisely determine a transferor partner's share of partnership liabilities, but provides flexibility in such computation by allowing the use of an alternate determination date. Note that one of the determination dates is the first day of the tax year that includes the date of the transfer. To the extent that the partnership is comfortable that liability allocations on the first date of such year would not be different from those on the last day of the preceding year, such partnership effectively may still be able to rely on the most recently issued Schedule K-1, at least for non-controlling partner transferors.

In situations when the transferor's amount realized cannot be determined due to a lack of knowledge of the transferor's share of partnership liabilities and has not received or cannot rely on a liability certification, the proposed regulations provide that the amount required to be withheld is the amount realized not including the decrease in the transferor's share of liabilities. This effectively results in 100% withholding of consideration paid by the transferee. Notice 2018-29 contains a similar provision.

Prior to the effective date of the final regulations, taxpayers may rely on either Notice 2018-29 or the proposed regulations (provided that all provisions of the proposed regulations governing general rules, transferee withholding, and withholding agent liability are followed).

Secondary withholding imposed on partnership's distributions to transferee

Section 1446(f)(4) provides that a partnership is required to deduct and withhold from distributions to a transferee to the extent that the transferee failed to withhold any amount required under section 1446(f)(1). The secondary withholding under section 1446(f)(4) is imposed on the partnership for all distributions made to the transferee partner beginning 30 days after the transfer date, or 15 days after the date the partnership acquires knowledge of the transfer. A partnership must withhold the full 10% tax on the amount realized, reduced by the amount withheld by the transferee. A partnership generally may take into account any adjustments that might have been available to the transferee,

The proposed regulations would provide rules to implement the partnership's requirement to withhold on distributions to a transferee on the under withheld amount (plus interest).

Partnership requirement to withhold

- *Reasonable reliance on certifications provided by transferee:* A partnership must review the certifications received from the transferee to determine whether the transferee withheld the appropriate amount. A partnership generally may rely on those certifications if timely received provided that the partnership does not know, or have reason to know, that the underlying information is incorrect or unreliable.

KPMG observation

This provision effectively may result in the partnership auditing the certification to determine whether it can be relied upon. A transferee may have relied on the transferor's certification and not have withheld on proceeds on the transfer date. As such, to avoid the chance that the partnership may begin withholding on distributions to the transferee, it may behoove a transferee to consult with the partnership to ascertain whether the partnership shall in fact be relying on the certification.

- *Failure to notify partnership or untimely notification:* A partnership must withhold the full 10% tax on the amount realized, reduced by the amount withheld by the transferee. A partnership that does not receive the required notification from the transferee (as described below) must begin withholding on all distributions until such notification is received. However, in that instance where the required notification is provided late, the partnership cannot take into account any adjustments that might have been available to the transferee.

KPMG observation

The timely notification to the partnership by the transferee is to be made within 10 days of the transfer. Since failure to timely provide such notice can result in withholding against their distributions in situations where the amount may have been properly subject to modification by the transferee, transferee partners should be diligent as to this procedural requirement. A transferee partner cannot itself apply for a refund of any such excess withholding, but must rely on the partnership to make such claim on its behalf.

- *No section 1446(f)(4) withholding required if the partnership is the transferee:* The secondary withholding under section 1446(f)(4) is not imposed on the partnership when the partnership is the transferee (in situations where the partnership makes a distribution to the transferor), because the partnership would remain primarily liable under section 1446(f)(1).

Withholding rules

- *Withholding amount:* If required to withhold under section 1446(f)(4), a partnership must withhold a tax equal to 10% of the amount realized on the transfer, reduced by any amount already withheld by the transferee, plus any computed interest. Withholding on distributions to transferees would apply only after the transferee has either failed to properly withhold under section 1446(f)(1) or has not complied with the procedural requirements. A partnership can generally take into account any valid certifications that would apply to exempt or reduce the withholding.

- *Timing:* If subject to section 1446(f)(4) withholding, a partnership must begin to withhold on distributions made to the transferee on the later of the date that is: (i) 30 days after the transfer; or (ii) 15 days after the partnership acquires actual knowledge of the transfer.
- *Ordering rule:* Withholding would be applied on the entire amount of each partnership distribution to the transferee until a certification is received by the partnership providing that an exception applies or identifying the amount required to be withheld.
- *Reporting:* A partnership required to withhold under section 1446(f)(4) must report and pay the tax withheld using Form 8288, *U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests*, and new Form 8288-C, *Statement of Withholding Under Section 1446(f)(4) for Withholding on Dispositions by Foreign Persons of Partnership Interests*.

Effect of withholding on the transferor and transferee

- *Transferor's non-resident income tax return filing requirement unaffected:* The withholding of tax under section 1446(f)(4) does not relieve a non-resident alien individual or foreign corporation subject to tax under section 864(c)(8) from its U.S. federal income tax return filing and payment obligation.
- *Collection of transferor's income tax liability:* To the extent the amount withheld by the transferee (or the partnership) equals or exceeds the transferor's U.S. federal income tax liability, such tax will not be collected from the transferor.
- *Transferee's liability on amounts withheld by the partnership under section 1446(f)(4):* A transferee's primarily withholding tax liability under section 1446(f)(1) is treated as satisfied to the extent that it is withheld upon under section 1446(f)(4). However, if the amount of tax withheld from the transferee by the partnership exceeds such transferee's section 1446(f)(1) liability, only the partnership may claim a refund on behalf of the transferee for the excess amount.

Liability for failure to withhold

If a transferee or other person required to withhold under the proposed regulations fails to withhold tax under section 1446(f), such person is liable for the tax under section 1461 but only to the extent that the tax is not otherwise paid (e.g., by the notifying transferor or another person required to withhold). Nevertheless, the withholding agent will not be relieved of any interest and penalties resulting from its failure to withhold under the rules prescribed in the proposed regulations.

Withholding on the transfer of a publicly traded partnership interest by a foreign person

The proposed regulations would provide rules for withholding on transfers of partnership interests that are publicly traded on an established securities market or are readily tradeable on a secondary market of substantial equivalent ("PTP interests"). These rules apply to publicly traded partnerships ("PTPs") that are not treated as corporations for federal income tax purposes.

Currently, withholding with respect to PTP interests are suspended pursuant to Notice 2018-08. Finalization of the proposed regulations would end the suspension and withholding would be required for transfers of PTP interests on or after 60 days following the finalization date of the regulations.

The proposed regulations contain rules governing the requirement to withhold and the amount and remittance of withholding amounts. These proposed rules include the following:

Withholding on PTP interests

- *Brokers must withhold:* The proposed regulations would provide that transferees are not required to withhold with respect to transfers of PTP interests effected by a broker. Instead, such brokers are required to withhold. For this purpose, a broker includes a person that in the ordinary course of its trade or business effects sales made by others, and that receives all or a portion of the amount realized on behalf of a transferor. A broker may include a clearinghouse organization. In the case of multiple brokers, the proposed regulations would provide ordering rules to determine obligation to withhold and amount withheld. Brokers are not generally required to withhold if provided with a certification of exception to withholding.
- *Five exceptions to withholding on PTP interests:* The proposed regulations would provide five exceptions to withholding on PTP interests: (1) certification of non-foreign status, (2) less than 10% effectively connected gain exception, (3) qualified current income distributions exception, (4) exception for withholding on proceeds that are otherwise subject to withholding under section 3406, and (5) exceptions for a claim of treaty benefits.
- *Amount realized for withholding and liabilities:* The proposed regulations would provide that brokers treat the gross proceeds paid or credited to the customer as the amount realized that is subject to 10% withholding. A publicly traded partnership that is a transferee (due to a distribution to its partners) treats the cash or fair market value of property distributed or to be distributed as the amount realized that is subject to 10% withholding. As such, the partner's share of partnership liabilities allocable to a PTP interest is not included in amount realized.
- *Generally no withholding by PTP on distributions on transferee PTP interests:* The proposed regulations would not generally require the secondary partnership withholding obligation with respect to distributions on PTP interests held by transferees. The exception to this rule is proposed to be in the limited circumstances where a publicly traded partnership determines that it has published a qualified notice that falsely states that an exemption applied, and in circumstances where the IRS provides notice to the partnership of same.
- *Modifications to the qualified notice contents.* The proposed regulations would also provide changes to the existing qualified notice rules to add certain detailed information that is necessary to determine the amount required to be withheld. Such notice would be required to be posted in a readily-accessible format in an area of the primary public website of the publicly traded partnership.

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