

## Withholding Guidance Issued on Sale of Interests in a Partnership with US Assets

*The guidance shows Treasury Regulations will ease administrative challenges and exclude certain transfers from the new withholding regime.*

### Key Points:

- Taxpayers can deliver IRS Form W-9 or an affidavit to establish the taxpayer is not a foreign person.
- No withholding is required if no gain is recognized or if ECI is less than 25% of the total gain.
- Procedures are established to identify the amount of partnership liabilities taken into account.
- Partnerships are not required to withhold under Section 1446(f)(4) until future guidance is issued.

On April 2, 2018, the Internal Revenue Service (the IRS) issued Notice 2018-29 (the Notice) to provide interim guidance on certain withholding rules that apply to a foreign person's disposition of an interest in a partnership, if that partnership owns assets that generate income that is effectively connected with a US trade or business (effectively connected income or ECI).

Section 864(c)(8),<sup>1</sup> enacted as part of the Tax Cuts and Jobs Act (the Act),<sup>2</sup> provides that gain from the sale, exchange, or other disposition of a partnership interest by a nonresident alien or foreign corporation is ECI to the extent the person disposing of the interest would have recognized ECI had the partnership sold all of its assets for fair market value. Section 1446(f)(1), also enacted as part of the Act, generally provides that if any portion of the gain on a disposition of an interest in a partnership would be treated as ECI under Section 864(c)(8), the transferee must deduct and withhold a tax equal to 10% of the transferor's amount realized unless certain exceptions are met.

The Notice provides guidance on a number of previously unanswered questions, including the process for depositing amounts withheld under Section 1446(f) and clarifying that taxpayers can rely on an IRS Form W-9 to establish that a person is not a foreign person such that no withholding under Section 1446(f) is required. In addition, the Notice provides relief to taxpayers by establishing a number of exemptions from withholding in various circumstances, including if no gain is recognized by the transferor. The Notice also provides procedures that can be used in certain situations to identify the amount of partnership liabilities that must be taken into account when determining the amount required to be withheld. Even if withholding is not required, foreign transferors are still liable for the tax imposed by Section 864(c)(8).

The Notice applies to the disposition of a partnership interest that is not publicly traded.<sup>3</sup> Taxpayers generally may rely on the guidance and procedures described in the Notice prior to the issuance of further guidance or regulations.

## Establishing a Transferor is not a Foreign Person

The Notice clarifies the manner in which a person transferring an interest in a partnership can establish that it is not a foreign person such that no withholding under Section 1446(f) applies. Specifically, the Notice provides that a transferor can provide an affidavit, signed under penalties of perjury, stating its US taxpayer identification number and that it is not a foreign person. In addition, the Notice allows a transferor to submit and the transferee to rely on an IRS Form W-9 (as opposed to a separate affidavit) as long as the IRS Form W-9 contains all the information that would be contained in the affidavit and the transferee does not have knowledge that the information in the IRS Form W-9 is false. The ability to rely on an IRS Form W-9 simplifies the process for establishing that a transferor is not a foreign person because partnerships generally receive an IRS Form W-9 when admitting a partner who is not a foreign person and brokers generally receive IRS Forms W-9 when paying amounts in sales transactions to transferees that are not foreign persons.

## Withholding Relief in Certain Situations

The Notice also provides relief from Section 1446(f) withholding in a number of situations, including in any of the following:

- **Non-recognition transactions**: No withholding is required upon the transfer of a partnership interest if the transferee receives from the transferor a notice that satisfies the general non-recognition notice requirements under Section 1445.
- **No realized gain**: No withholding is required if the transferee receives a certificate, issued by the transferor and signed under penalties of perjury, stating that the transferor will not realize gain upon the transfer of its partnership interest.
- **Less than 25% ECI in three prior taxable years**: No withholding is required if the transferee receives a certificate from the transferor, signed under penalties of perjury and provided no earlier than 30 days prior to the transfer, that the transferor was a partner in the partnership for the entirety of the immediately prior taxable year and the two taxable years that precede it, and that the transferor's allocable share of ECI for each such taxable year was less than 25% of the transferor's total distributive share of income for the relevant year. A transferor that did not have a distributive share of income in any of its three immediately prior taxable years during which the partnership had ECI cannot provide such certification. The exception does not apply with respect to gain recognized in connection with distributions from a partnership to a partner.
- **Less than 25% of gain is ECI**: No withholding is required if the partnership in which an interest is transferred provides a certificate dated no earlier than 30 days before the transfer and stating that the amount of gain that would be ECI (including pursuant to Section 897) if the partnership sold all of its assets at their fair market value would be less than 25% of the total gain.
- **Amount to be withheld exceeds amount realized less decrease in transferor's share of partnership liabilities**: The amount required to be withheld will not exceed the amount realized less the decrease in the transferor partner's share of partnership liabilities, even if Section 1446(f) otherwise would require withholding a greater amount. This exception does not apply if the transferee is the partnership in which the transferor is a partner or if the transferee is related to the transferor.

## **Determining Liabilities for Calculating Amount Realized**

The Notice also provides rules that ease the administrative burden associated with determining the amount of liabilities that are taken into account when calculating the amount to be withheld under Section 1446(f)(1). In particular, under the Code, the amount realized generally includes a reduction in the transferor's share of partnership liabilities. Obtaining the information necessary to determine this amount can be difficult, especially if the transferor owns a non-controlling interest in a partnership.

Under the Notice (and under regulations to be issued in the future), a transferee may rely on two different certifications to determine the amount of liabilities taken into account in calculating the amount realized. The first certification can only be provided by a transferor that is not a controlling partner and must state both (i) the amount of the transferor's share of partnership liabilities reported on the most recently received Schedule K-1 from the partnership for a partnership taxable year that closed no more than 10 months before the date of transfer and (ii) that the transferor does not have actual knowledge of events occurring after the Schedule K-1 was issued that would cause the amount of partnership liabilities at the time of transfer to significantly differ (defined as 25% or more) from the amount shown on the Schedule K-1.

The second certification can be provided by the partnership in which the interest is being transferred and must both (i) identify the amount of the transferor's share of partnership liabilities, which may be the amount reported on the most recently prepared Schedule K-1 and (ii) affirm that the partnership does not have actual knowledge of events occurring after its determination of the amount of the transferor's share of partnership liabilities that would cause the amount of the transferor's share of partnership liabilities at the time of the transfer to significantly differ (defined as 25% or more) from the amount shown on the certification provided to the transferee.

In addition, the Notice provides relief when a transferee does not have knowledge of the amount of the transferor partner's share of partnership liabilities and does not receive a certificate with this information as provided in the procedures set forth above. In this case, the amount realized is determined without regard to the decrease in the transferor partner's share of partnership liabilities. A transferee can rely on this rule only if the transferee is not the partnership in which the transferor is a partner and is not a related person to the transferor. One unclear aspect of this rule is whether the transferee has any obligation to request either of the certificates discussed above or other information so the transferee can determine the amount of the transferor partner's share of partnership liabilities.

## **Partnerships Not Required to Withhold Under Section 1446(f)(4) Until Future Guidance is Issued**

Section 1446(f)(4) generally requires a partnership to withhold on amounts otherwise distributable to a transferee partner if the transferee partner fails to comply with Section 1446(f) in the acquisition of its partnership interest from the transferor. The Notice suspends this requirement until future guidance is issued.

## **Additional Regulatory Guidance**

In addition, the US Treasury and the IRS plan to issue regulations:

- That allow a partnership to rely on its book and records, or on a certification received from a distributee partner, to determine when a distribution from a partnership exceeds a partner's tax basis in a partnership<sup>4</sup>

- To provide for coordination between the withholding required under Section 1445(e)(5) and Section 1446(f)(1)
- To clarify that withholding under Section 1446(f)(1) is applicable if an interest in an upper-tier partnership is transferred if the upper-tier partnership owns an interest in a lower-tier partnership that earns ECI

## Welcome Guidance for Taxpayers

Overall, the guidance in the Notice is welcome because it addresses many previously unanswered questions, provides immediate relief for certain situations, and indicates that future guidance will take into account the administrative issues that exist with complying with the new withholding regime.

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## Endnotes

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- <sup>1</sup> All references to "Section" refer to sections of the Internal Revenue Code of 1986, as amended (the Code).
- <sup>2</sup> Public Law No. 115-97 (Dec. 22, 2017). Shortly before final Congressional approval of the Act, the Senate parliamentarian ruled that the previously attached short title, the "Tax Cuts and Jobs Act," violated procedural rules governing the Senate's consideration of the legislation. Accordingly, the Act does not bear a short title, although commentators generally have continued to refer to it as the Tax Cuts and Jobs Act. For further detail on a range of aspects of the Act, see Latham's January 2018 *White Paper*, [US Tax Reform: Key Business Impacts, Illustrated With Charts and Transactional Diagrams](#), and the [Latham & Watkins US Tax Reform Resource Center](#).
- <sup>3</sup> Notice 2018-18, 2018-7 I.R.B. 352, which was issued on December 29, 2017, suspended the requirement to withhold on dispositions of certain interests in publicly traded partnerships.
- <sup>4</sup> Under Section 731(a), a partner recognizes gain on the distribution of money from a partnership when the money distributed exceeds the adjusted basis of the partner's interest in the partnership immediately before the distribution. Any gain recognized under Section 731(a) is considered gain from the sale or exchange of a partnership interest and, therefore, Section 1446(f)(1) can apply in certain cases when a distribution of money results in gain under Section 731(a).