

New IRC 864(c)(8) Withholding Rules on Partnership Sales: Calculations and Affidavit of Exemption

TUESDAY, JULY 31, 2018, 1:00-2:50 pm Eastern

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TUESDAY, JULY 31, 2018

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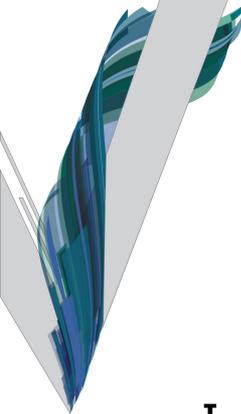
New IRC Section 864(c)(8) Withholding Rules on Partnership Sales

July 31, 2018

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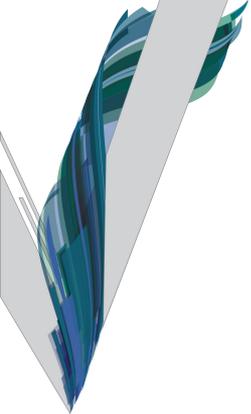
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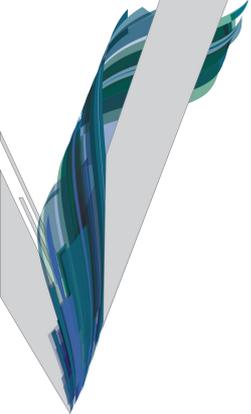
Agenda

- Introductions
- Prior Treatment
- Section 864(c)(8)—Gain on sale of interest in partnership with a U.S. trade or business
- Section 1446(f)—Withholding requirements (and exceptions) with respect to Section 864(c)(8) Gain
- Calculation of Gain/Forms and Filing Requirements
- Examples
- Q&A



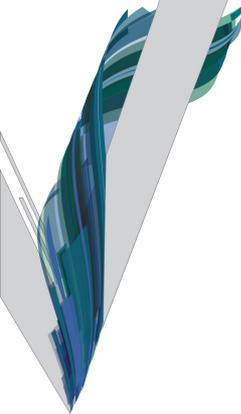
Prior Treatment of Sale of Partnership Interests

Revenue Ruling 91-32 vs. *Grecian Magnesite*



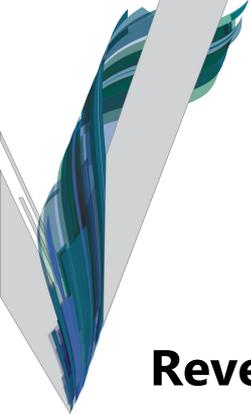
Prior Treatment of Sale of Partnership Interests

- **Background:** Aggregate versus Entity Approach
 - **Aggregate Approach:** a partnership is an aggregate of its partners; a partner's interest in a partnership can be viewed as the partner co-owning interests in the partnership's underlying property
 - **Entity Approach:** a partnership is a separate entity with legal existence apart from its partners



Prior Treatment of Sale of Partnership Interests

- **Revenue Ruling 91-32**
Gain = Effectively Connected Income
- ***Grecian Magnesite***
Gain = Not Effectively Connected Income



Prior Treatment of Sale of Partnership Interests

Revenue Ruling 91-32

- **Facts**

- Foreign Partner invested in U.S. partnership that is engaged in a trade or business through a fixed place of business in the U.S.
- U.S. partnership owns appreciated real and personal property both in Country X and personal property in the U.S. that is used or held for use in the partnership's trade or business in the U.S.
- Foreign Partner disposes of his/her partnership interest

- **Issue**

- What are the U.S. tax consequences of the disposition of a foreign partner's interest in a foreign or domestic partnership that conducts a trade or business through a fixed place of business or has a permanent establishment in the U.S.?

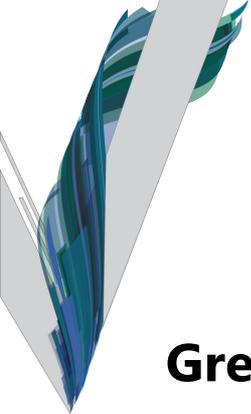


Prior Treatment of Sale of Partnership Interests

Revenue Ruling 91-32

- **Ruling:**

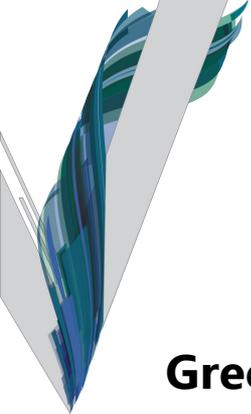
- In applying sections 864(c) and 865(e), it is appropriate to treat a foreign partner's disposition of its interest in a partnership that is engaged in a trade or business through a fixed place of business in the U.S. as an **aggregate interest** in the partnership's underlying property for ECI sourcing/character
- A foreign partner's gain or loss from the disposition of an interest in a partnership that is engaged in a trade or business through a fixed place of business in the U.S. **will be ECI gain or loss to the extent such gain or loss is attributable to ECI property of the partnership.**
- The gain is **presumed** to be U.S. source ECI gain in its entirety and subject to U.S. tax. If a loss, the loss is presumed to be foreign source non-ECI in its entirety, unless the partner can show otherwise.



Prior Treatment of Sale of Partnership Interests

Grecian Magnesite Mining

- **Facts:**
 - Foreign Corporate Partner invested in U.S. LLC that is classified as a partnership for U.S. tax purposes.
 - U.S. LLC is engaged in a trade or business through a fixed place of business in the U.S. – mining and extracting magnesite in the U.S.
 - Foreign Corporate Partner does not have an office, employees, or business in the U.S.
 - Foreign Corporate Partner redeems its interest in the U.S. LLC
 - Foreign Corporate Partner did concede that a portion of the gain from the redemption was attributable to the LLC's real estate assets (US Real Property Interests or USRPIs) that were taxable as ECI pursuant to section 897(g)
 - Realized gain on redemption totaled over \$6.2 million - \$2.2 million was attributable to USRPI

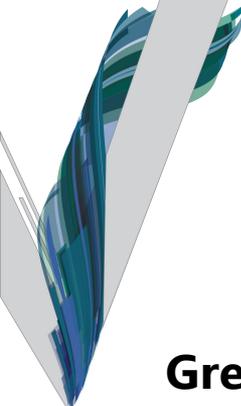


Prior Treatment of Sale of Partnership Interests

Grecian Magnesite Mining

- **Issue:**

Foreign Corporate Partner contends that the remainder of the disputed gain - \$4 million – is not taxable for U.S. purposes as it is not effectively connected to a U.S. trade or business



Prior Treatment of Sale of Partnership Interests

Grecian Magnesite Mining

- **Ruling:**

- Found Revenue Ruling 91-32 unpersuasive
- Initially determined that a redemption of a partnership interest should be treated the same as a sale
- Section 741 calls for an **entity rather than aggregate approach** – with the exception of the sale of “hot assets” and real estate assets
- Applied Section 865(a) rule that gain on the sale of personal property is sourced based on the residence of the seller
- Rejected the IRS argument that the gain in U.S. source under Section 865(e)(2)(A) because it was attributable to a U.S. office of the LLC



New Provisions on Sale of Partnership Interests

Sections 864(c)(8) and 1446(f)



Section 864(c)(8)

Gain on Sale of Interest in Partnership with USTB

New section 864(c)(8)—

(A) In general

Notwithstanding any other provision of this subtitle, if a nonresident alien individual or foreign corporation owns, directly or indirectly, an interest in a partnership which is engaged in any trade or business within the United States, gain or loss on the sale or exchange of all (or any portion of) such interest shall be treated as effectively connected with the conduct of such trade or business to the extent such gain or loss does not exceed the amount determined under subparagraph (B).



Section 864(c)(8)

Gain on Sale of Interest in Partnership with USTB

(B) Amount treated as effectively connected

The amount determined under this subparagraph with respect to any partnership interest sold or exchanged—

(i) in the case of any gain on the sale or exchange of the partnership interest, is—

(I) the portion of the partner's distributive share of the amount of gain which would have been effectively connected with the conduct of a trade or business within the United States if the partnership had sold all of its assets at their fair market value as of the date of the sale or exchange of such interest, or

(II) zero if no gain on such deemed sale would have been so effectively connected, and



Section 864(c)(8)

Gain on Sale of Interest in Partnership with USTB

- (ii)** in the case of any loss on the sale or exchange of the partnership interest, is—
- (I)** the portion of the partner's distributive share of the amount of loss on the deemed sale described in clause (i)(I) which would have been so effectively connected, or
 - (II)** zero if no loss on such deemed sale would have been so effectively connected.

For purposes of this subparagraph, a partner's distributive share of gain or loss on the deemed sale shall be determined in the same manner as such partner's distributive share of the non-separately stated taxable income or loss of such partnership.



Section 864(c)(8)

Gain on Sale of Interest in Partnership with USTB

(C) Coordination with United States real property interests

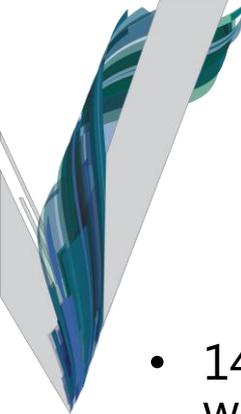
If a partnership described in subparagraph (A) holds any United States real property interest (as defined in section 897(c)) at the time of the sale or exchange of the partnership interest, then the gain or loss treated as effectively connected income under subparagraph (A) shall be reduced by the amount so treated with respect to such United States real property interest under section 897.



Section 1446(f)

Withholding Requirements – Transferee Obligation

- **New Section 1446(f)**—A nonresident alien individual or foreign corporation that derives effectively connected gain (but not loss) under Section 864(c)(8), the transferee of the partnership interest must generally withhold **10%** (or a reduced rate determined by the Secretary) of the amount realized on the disposition
- Applies to dispositions occurring on or after **December 31, 2017** where there is a gain
- Notice 2018-08—suspends Section 1446(f) withholding obligation for sales of interests in publicly traded partnerships (PTPs) until guidance is issued



Section 1446(f)

Withholding Requirements – U.S. Person Affidavit Exception

- 1446(f)(2) provides that a transferee is not required to deduct and withhold if the transferor furnishes an affidavit stating, under penalty of perjury, the transferor's U.S. tax identification number and that the transferor is not a foreign person
- Notice 2018-29, Section 6.01 generally adopts the rules under Treas. Reg. 1.1445-2(b) for FIRPTA certifications
- Notice also provides that until regulations are issued, the transferor can submit a W-9 instead of the affidavit
- U.S. Person Affidavit contents:
 - Certification that the transferor is not a foreign person (or disregarded entity);
 - Transferor's name, tax identification number, and address;
 - Signed under penalties of perjury



Section 1446(f)

Withholding Requirements - Burden on Partnership

- If the transferee fails to withhold the full amount required to be withheld under Section 1446(f), the burden falls to the partnership to deduct and withhold tax from distributions to the distributee in an amount equal to the amount the transferee failed to withhold (plus interest) (see Section 1446(f)(4)).
- Notice 2018-29 suspends this obligation until regulations are issued
- Treasury and IRS considering rules that would relieve the partnership of its obligation if it provides the information required by a transferor and transferee to comply with the requirements under sections 864(c)(8) and 1446(f), including:
 - Certifications with respect to ECI;
 - Calculation of the tax liability to the transferor; and
 - Information necessary to calculate the transferor's amount realized (including calculations relating to Section 752)



Section 1446(f)

Calculation of Amount to be Withheld

- Section 1446(f) withholding only applies to the portion of the gain (if any) on the disposition of a partnership interest that would be treated as ECI under Section 864(c)(8)
- 10% of the amount realized is required to be withheld
 - Until guidance is provided, no withholding is required where in situations where no gain would be recognized
- Partner is able to include partnership liabilities – two rules are applicable
- See Examples 2 and 3 for coordination with Section 897



Section 1446(f) Withholding Requirements

Interim relief from obligation to withhold – See IRS Notice 2018-29

- Certification of no gain—To prevent withholding when there is no gain, Notice 2018-29 provides that a transferee can rely on a certification from the transferor that the disposition will not result in gain
- De minimis ECI from the partnership
 - If the transferor certifies that for the past three years that its taxable ECI from the partnership was less than 25% of its total income from the partnership, the transferee is not required to withhold
 - If the transferor cannot so certify, the transferee can instead rely on a certification from the partnership that the partnerships' ECI under Section 864(c)(8) would be less than 25% of its total gain on the deemed sale
- Non-recognition transaction—until guidance is provided, no withholding is required in transactions in which no gain is recognized



Section 1446(f) Forms and Filings

Forms and Filings

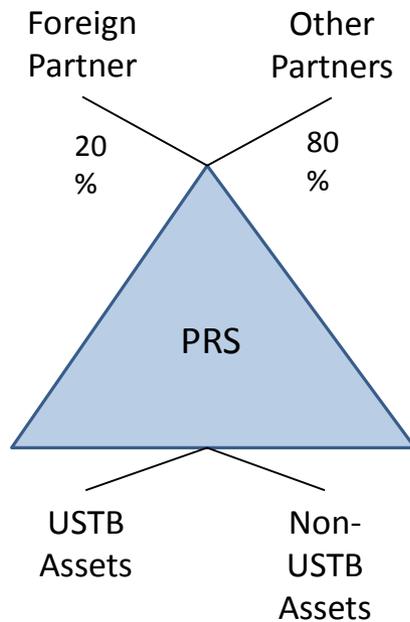
- Requirements essentially mirror those of FIRPTA withholding
- Utilize Forms 8288 and 8288-A with the inclusion of “Section 1446(f)(1) withholding” at the top of each page
- Withholding must be paid in and the above forms filed within 20 days of the date of disposition
- Penalty and interest relief provided for those transactions that occurred on or before May 31, 2018 as long as forms are filed/payments made before May 31, 2018
- The IRS is NOT issuing Withholding Certificates



Examples

Example 1

Sale of Partnership with USTB and non-USTB Assets



U.S. Federal Tax Classifications

-  Corporation/Trust
-  U.S. Partnership
-  Branch
-  Disregarded Entity "DRE"

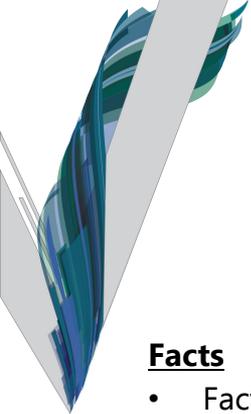
Ownership is 100% unless otherwise noted

• Facts

- Partnership (PRS) is engaged in businesses both within and without the United States; PRS maintains a U.S. office
- PRS does not own any USRPIs within the meaning of Section 897 and none of its assets constitute unrealized receivable or inventory items within the meaning of Section 751
- Foreign Partner (FP) owns a 20% interest in the capital and profits of PRS and disposes of its interest in PRS in a taxable sale for a gain

• Result

- Rev. Rul. 91-32 Approach—FP's gain is treated as ECI to the extent attributable to PRS's USTB assets
- *Grecian Magnesite* Approach—FP's gain is treated as foreign source under Section 865(a) and is not subject to U.S. income tax
- Section 864(c)(8) Approach—As in Rev. Rul. 91-32
 - 10% of the amount realized is required to be withheld under Section 1446(f)



Example 2

Facts **Sale of Partnership with USTB and USRPIs**

- Facts are the same as in Example 1, except that PRS is engaged in business only in the U.S., and its assets include the following:

	FMV	Adjusted Basis
U.S. Real Property (USRPI)	\$1000	\$200
Other USTB Assets	\$1000	\$200
Total	\$2000	\$400

- FP's basis in its 20% interest is \$80; FP disposes of its interest in a taxable transaction for \$400 resulting in gain of \$320

Result

- Deemed Sale**—if PRS sold all of its property at FMV, it would realize \$1600 of gain (\$800 attributable to the USRPI, and \$800 to the other USTB assets), all of which would be treated as ECI. P's distributive share of the gain would be \$320 (\$160 attributable to the USRPI, and \$160 attributable to the other USTB assets)
- Coordination with Section 897**—The amount treated as ECI under Section 864(c)(8) is equal to FP's distributive share of the amount of gain which would have been treated as ECI on the deemed sale (all \$320); however, the gain of \$320 must be reduced under Section 864(c)(8)(C) by the amount treated as ECI under Section 897 (\$160). Therefore, FP is treated as deriving ECI of \$160 under Section 864(c)(8)
- Withholding obligations**
 - Section 1446(f) applies because any portion of the gain is treated as ECI under Section 864(c)(8) (\$160), so the transferee must withhold \$32 under this provision (10% of the entire amount realized)
 - If PRS were a 50/90 partnership under Temporary Treas. Reg. Section 1.1445-11T(d), it is unclear whether section 1445 withholding would also apply, as there are currently no coordination rules or guidance between the two withholding provisions



Example 3

Sale of Partnership with USRPIs Only

Facts

- Facts are the same as in Example 2, except its only assets are USRPIs with a FMV of \$2000 and adjusted basis of \$400.

Result

- **Deemed Sale**—as in Example 2, if PRS sold all of its property at FMV, it would realize \$1600 of gain (now entirely attributable to USRPIs), all of which would be treated as ECI. P's distributive share of the gain would be \$320 (entirely attributable to the USRPI)
- **Coordination with Section 897**—The amount treated as ECI under Section 864(c)(8) is equal to FP's distributive share of the amount of gain which would have been treated as ECI on the deemed sale (all \$320); however, the gain of \$320 must be reduced under Section 864(c)(8)(C) by the amount treated as ECI under Section 897 (\$320). Therefore, FP is not treated as deriving ECI under Section 864(c)(8)
- **Withholding obligations**
 - Section 1446(f) does not apply because no portion of the gain is treated as ECI under Section 864(c)(8); instead, the entire gain is treated as ECI under Section 897
 - If PRS were a 50/90 partnership under Temporary Treas. Reg. Section 1.1445-11T(d), section 1445 withholding would apply, and 15% of the amount realized would be required to be withheld under Section 1445(e)(5) (\$48)