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Taxation of Foreign Persons Who Dispose of Interests in Partnerships

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1. Section 864(c)(8)

1.1. Background

In 1991, the Internal Revenue Service ("Service") issued Rev. Rul. 91-32, [2] holding that gain or loss of a foreign partner that disposes of its interest in a partnership that is engaged in a trade or business through a fixed place of business in the United States will be gain from U.S. sources effectively connected with a U.S. trade or business ("ECI") or will be ECI loss that is allocable to United States source ECI gain, to the extent that the partner's distributive share of unrealized gain or loss of the partnership would be attributable to ECI (United States source) property of the partnership. This ruling has been heavily criticized by tax professionals.[3] The Obama Administration, in its proposed budget, recommended codifying the result in Rev. Rul. 91-32.[4]

In July 2017, the U. S. Tax Court, in Grecian Magnesite Mining Co. v. Commissioner[5] ("Grecian Magnesite"), rejected the holding in Rev. Rul. 91-32 and instead held that gain or loss recognized by a foreign person upon the disposition of a partnership interest is generally not considered effectively connected gain or loss with respect to a U.S. trade or business. Many tax lawyers applauded the decision of the Tax Court.

However, soon after the taxpayer's victory, Congress, apparently as part of its efforts to raise revenue to pay for the tax cuts in P.L. 115-97, enacted sections 864(c)(8) and 1446(f) of the Internal Revenue Code of 1986, as amended (the "Code"). The enactment of section 864(c)(8) was intended to override the result in Grecian Magnesite and to codify the holding in Rev. Rul. 91-32. Specifically, it provides that gain or loss recognized by a nonresident alien individual or

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[2] 1991-1 C.B. 107. See also Field Attorney Advice FAA 20123903F (released Sept. 28, 2012).

[3] See, in particular, Blanchard, "Rev. Rul. 91-32: Extrastatutory Attribution of Partnership Activities to Partners," 76 Tax Notes 1331 (1997); Department of the Treasury, General Explanations of the Administration's Fiscal Year 2013 Revenue Proposals, at 96 (2012); see the somewhat milder criticism in Jackel, "Aggregate and Entity in the Partnership World", Tax Notes (July 20, 2012). Mr. Jackel surveyed 60 years of authority on whether a sale of a partnership interest should be based on an aggregate or entity theory and concluded "I do not believe that any consistent theory of what is 'appropriate' can be derived from those authorities. If I am correct, then predicting the results of any situation is a matter of making the best guess at the most appropriate tax policy result. After almost 60 years of the existence of subchapter K, that should not be the case."

[4] Office of Management and Budget, 2013. Budget of the United States Government, Fiscal Year 2013. Office of Management and Budget, Washington, DC. This proposal too was met with heavy criticism, in particular from Kimberly Blanchard. See "Rev. Rul. 91-32 May Be Granted Authority — 20-Plus Years Late", 41 TM International Journal 237 (2012).

[5] 149 T.C. No. 3 (July 13, 2017)

foreign corporation from the sale, exchange or disposition[6] of a directly or indirectly held partnership interest generally is treated as ECI to the extent that such gain or loss does not exceed the gain or loss such person would have recognized as effectively connected gain or loss had the partnership sold all of its assets at fair market value as of the date of the transfer[7].

Section 864(c)(8)(E) gives the Treasury authority to promulgate regulations or other guidance determined to be appropriate for the application of section 864(c)(8), including with respect to various corporate nonrecognition provisions.[8] Finally, going beyond reversing (retroactively to November 27, 2017) the holding in Grecian Magnesite, Congress enacted a new withholding requirement, section 1446(f), effective January 1, 2018, which is described in part 2 of this article. Treasury has already announced the suspension of the application of section 1446(f) to dispositions of publicly traded partnership interests and it is apparently considering doing the same for other partnership interests.[9]

As described below many questions are raised by sections 864(c)(8) and 1446(f), and the need for guidance is urgent. In the following part of the article, we note some issues of particular concern under section 864(c)(8), although there are numerous others.

1.2.Interaction of Section 864(c)(8) with Nonrecognition Provisions

First, practitioners have raised the question of the interactions between section 864(c)(8) with nonrecognition provisions.[10] Indeed, section 864(c)(8) does not purport to override nonrecognition provisions: it only characterizes any gain or loss as effectively connected. There are two main issues that cause confusion here: the parallels drawn between the codification of Rev. Rul. 91-32 and the Foreign Investment in Real Property Tax Act 1980[11] ("FIRPTA"), and the ways in which section 864(c)(8) can be avoided.

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6 Section 864(c)(8)(D) specifically states that the term sale of exchange means "any sale, exchange, or other disposition."

7 Section 864(c)(8)(C) gain or loss under section 864(c)(8) will be reduced by gain or loss treated as effectively connected under section 897.

8 Specifically, sections 332 (liquidation of a corporation into its 80% parent corporation, 351 (taxfree incorporation), 354 (corporate reorganizations), 355 (spinoffs, etc.), 356 (boot in section 351 and 354 transactions), and 361 (treatment of corporations in reorganizations).

9 See paragraph 2.3 below.

10 *See, e.g.,* Letter to Treasury and IRS from New York State Bar Association re "Request for Immediate Guidance under Sections 864(c)(8) and 1446(f)" (February 2, 2018) available at www.nysba.org/Sections/Tax/Tax_Section_Reports/Tax_Section_Reports_2018/1387_Letter.html; letter to IRS from PriceWaterhouseCoopers LLP re "IRS Notice 2018-08: Request for Comments" (January 10, 2018), available at www.pwc.com/us/en/tax-services/publications/insights/assets/pwc-irs-notice-2018-08-request-for-comments.pdf; letter to IRS from Securities Industry and Financial Markets Association ("SIFMA") re "Request for delay in implementation of Section 1446(f) for non-publicly traded partnerships" (February 13, 2018), available at www.sifma.org/wp-content/uploads/2018/02/Request-for-delay-in-implementation-of-Section-1446f.pdf.

11 P.L. 96-499.

Parallels with FIRPTA. The codification of Rev. Rul. 91-32 in sections 864(c)(8) and 1446(f) presents certain similarities with the FIRPTA regime contained in sections 897 and 1445. Section 897 imposes a tax on the disposition of U.S. real property interests, but contains a provision in section 897(e) that specifically applies nonrecognition provisions where the transferor receives property the immediate sale of which would be taxable. Section 864(c)(8) contains no such provision, thereby implying (but not explicitly stating) that nonrecognition applies .

The Treasury has explicit authority to issue regulations but there is no indication what such regulations should say. If the Treasury simply follows the section 897(e) template, a simple incorporation of a foreign partner's partnership interest under section 351 would be taxable because the transferor would be exchanging an interest in a partnership (taxable) for an interest in a corporation (nontaxable unless the corporation was a U.S. real property holding corporation under section 897(c)).

Commentators have suggested several reasons why this regime would be inappropriate. First, it would create an unreasonable difference between the tax treatment of a foreign person who operates a business in the U.S. through a sole proprietorship or a single-member limited liability company ("LLC") and a foreign person who operates a business in the U.S. through a partnership. A sole proprietor would be able to do so tax-free under section 351, as would a single member LLC that is treated as a disregarded entity for Federal tax purposes. On the other hand, the foreign members of a partnership would be subject to section 864(c)(8) if the Treasury decides that nonrecognition provisions should not apply in these circumstances. There is no meaningful difference, other than the number of owners, between a sole proprietorship and a single-member LLC on the one hand and a partnership on the other.

Second, disallowing the use of nonrecognition would penalize a foreign person for choosing a partnership as the initial form of investment. A foreign person who initially chose to invest through a partnership could be prevented from converting the partnership to a domestic corporation if the conversion would give rise to taxable gain under section 864(c)(8).

Third, section 864(c)(8) appears to have been designed to counteract the inconsistent results where a foreign partner would be taxable on the sale of partnership assets but not on sale of a partnership interest, whereas from the buyer's perspective, both transactions would result in a step-up in basis in the partnership assets (in the latter case through the mechanism of an election under section 754). However, in a section 351 transaction (or generally, transactions in nonrecognition provisions), transferees take carryover or substitute basis in the property exchanged and the appreciation in the assets will remain taxable when the assets are eventually sold.

Strategies to Avoid Section 864(c)(8). Additional uncertainty arises because it is easy to envision transactions which produce identical results to a transfer of a partnership interest without actually transferring the interest.

Suppose it was desired for a partnership to incorporate. but because there is no guidance confirming that section 721 would apply, the parties are uncertain as to whether the transaction would be afforded nonrecognition treatment. The partnership might contribute its assets to a domestic corporation in a transaction governed by section 351. Subsequently, the partnership distributes stock in the corporation to the foreign partner. The economic result is the same, but no disposition of a partnership interest has taken place. Further, even if the distribution of the stock resulted in a deemed disposition of the partnership interest by the foreign partner, at the time of the disposition, the partnership would not have any asset the sale of which would give rise to ECI and so section 864(c)(8) by its terms would not apply.

As commentators have noted, section 864(c)(8)(E) gives the Treasury the authority to prescribe regulations regarding this tax. The Treasury should use this authority to clarify that section 864(c)(8) applies to nonrecognition events – or at least, to specify any limitations on the availability of nonrecognition treatment. The need for guidance is urgent because nonrecognition events such as tax-free incorporations are extremely common. For example, startup businesses frequently are organized as partnerships for U.S. tax purposes and then reorganized as corporations when they go public. Indeed, such transactions may become more common following the lowering of U.S. corporate income tax rates. The government needs to make its position clear on the tax consequences of incorporation for foreign partners and the incorporating partnerships.

1.3.Computation of Gain

There is a pressing need for guidance on how, exactly, gain is to be calculated under section 864(c)(8). The Service in Rev. Rul. 91-32 offered no guidance on this point and section 864(c)(8) and its legislative history are no more forthcoming. Among many examples where clarity is needed, one need look no further than Notice 2018-08, which, as the SIFMA comments remind us, notes that it is uncertain whether the amount realized comprises only cash and other property exchanged for the partnership interest, or whether partnership liabilities need to be taken into account under section 752(d).[12]

1.4.Interaction of Section 864(c)(8) and Treaty Provisions

It is not clear whether and to what extent section 864(c)(8) overrides income tax treaty provisions. The United States is a party to many income tax treaties with a provision dealing with capital gains.[13] In such provisions, it is typically provided that the United States may tax gains from the alienation of movable property forming part of the business property of a

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[12] Footnote 8, *supra*.

[13] *See, e.g.*, Convention for the Avoidance of Double Taxation and the Prevention of Fraud or Fiscal Evasion, U.S.-Italy, art. 13, Aug. 25, 1999; Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, U.S.-Netherlands, art. 14, Dec. 18, 1992; Convention for the Avoidance of Double Taxation with Respect to Taxes on Income, U.S.-Switzerland, art. 13, Oct. 2, 1996; Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, U.S.-Sweden, art. 13, Jan. 1, 1996.

permanent establishment in the United States, including gains from the alienation of the permanent establishment. However, it is not clear whether the disposition of a partnership interest constitutes the alienation of a permanent establishment. It is doubtful, at least, following Grecian Magnesite that gain from the sale of a partnership can be attributed to a permanent establishment that arises solely by attribution of the partnership's permanent establishment. At the very least, it would be helpful for Treasury to confirm that section 864(c)(8) does not apply if a hypothetical sale of partnership assets, although resulting in ECI, would not be taxed to a foreign partner resident in a treaty country because the partnership lacked a permanent establishment.

We await guidance from the government on these as well as other issues.

2. Section 1446(f)

2.1. Introduction

To enforce the tax imposed under new section 864(c)(8), Congress enacted a withholding requirement as section 1446(f).[14] Due to the haste in which the provision was enacted and the failure of the Republican legislators to allow any time at all for technical review and comment, section 1446(f) has raised a host of issues some of which may potentially only be resolved by technical corrections and many of which will require a stretched thin Service to provide guidance, forms and procedures. As a result, several calls have already been made for delay in the implementation of withholding requirement while the government sorts out the Congressional mess.[15]

Indeed, within a few days of enactment, the Service issued a notice in which it announced that it would suspending the application of the new law in the case of dispositions of certain publicly traded partnership interests.[16] In addition, the Service requested comments on the rules to be issued under the section 1446(f), specifically with regard to: (1) the application of section 1446(f) to interests in publicly traded partnerships, including the role of brokers in collecting the tax; (2) rules for determining the amount realized taking into account section 752(d); and (3) procedures for requesting a reduced amount to be withheld.[17] It also requested comments on whether there should be a temporary suspension of the Ssection 1446(f) for partnerships that are

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[14] Prior subsection (f) of section 1446, which provides regulatory authority to the IRS, was redesignated as subsection (g). Pub. L. 115-97 section 13501(b).

[15] *See, e.g.,* Chan, "New Section 1446(f) Withholding—A Possible Outline for Public Guidance", 27 Daily Tax Report (February 8, 2018) [David Chan is with KPMG but the article was written in his personal capacity]; letter to Treasury and Service from New York State Bar Association re "Request for Immediate Guidance under Sections 864(c)(8) and 1446(f)" (February 2, 2018); letter to Service from PriceWaterhouseCoopers LLP re "IRS Notice 2018-08: Request for Comments" (January 10, 2018).

[16] Notice 2018-08 (released January 8, 2018; published in IRB 2018-7 (February 12, 2018) at 352, available at www.irs.gov/pub/irs-irbs/irb18-07.pdf (viewed February 12, 2018)). See paragraph 2.3 below.

[17] *Id.*

not publicly traded partnerships.[18] Treasury representatives have included guidance on issues arising under section 1446(f) in the 2017-2018 Priority Guidance Plan, although without specifying a specific target date.[19]

It has also been reported that a Treasury official had stated at a conference in March that the Treasury and the IRS were planning to suspend application of section 1446(f) pending issuance of guidance. The Treasury apparently walked this back shortly thereafter, a spokesman saying only that guidance was planned.[20]

2.2.Overview of the Withholding Requirement

Section 1446(f) provides that, if any portion of the gain (if any) on any disposition of an interest in a partnership would be treated under section 864(c)(8) as effectively connected with the conduct of a trade or business within the United States (ECI), the transferee of the partnership interest must withhold tax equal to 10% of the amount realized on the disposition.[21] Although section 864(c)(8) applies to dispositions of partnership interests occurring on or after November 27, 2017, section 1446(f) applies only to dispositions occurring on or after December 31, 2017.[22]

The transferee does not have to withhold tax if the transferor provides to the transferee an affidavit under penalty of perjury, giving the transferor's U.S. taxpayer identification number and stating that the transferor is not a foreign person.[23] This exception does not apply if the transferee has actual knowledge that the affidavit is false or receives a notice from an agent for the transferor or the transferee that the affidavit or statement is false.[24] The exception also does not apply if regulations require the transferee to furnish a copy of the affidavit or statement and the transferee fails to furnish such copy at the prescribed time and in the prescribed manner.[25]

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[18] *Id.*

[19] Joint Statement by Treasury IRS, "Department of the Treasury 2017-2018 Priority Guidance Plan", Second Quarter Update (released February 7, 2018), Part 1, Item 15, available at www.irs.gov/pub/irs-utl/2017-2018_pgp_2nd_quarter_update.pdf (viewed February 11, 2018).

[20] BNA Daily Tax Report, "IRS Plans Notice on Withholding Rule for Non-Public Partnerships (Corrected)" (March 12, 2018)

[21] I.R.C. section 1446(f)(1).

[22] Pub. L. 115-97 section 13501(c).

[23] I.R.C. section 1446(f)(2). The New York State Bar Association comments, footnote 10 above, requested the government to confirm that IRS Form W-9 could be used for the purpose of the statement.

[24] I.R.C. section 1446(f)(2)(B)(i). The notice is required to be in the form described in I.R.C. section 1445(d).

[25] I.R.C. section 1446(f)(2)(B)(ii). It would be reasonable to expect the Service to follow the template in Treas. Reg. § 1.1445-2(b)(3), which requires the transferee of a U.S. real property interest to retain a copy of the certification until the end of the fifth taxable year following the taxable year in which the transfer takes place.

Agents of both the transferor and the transferee are liable if they know the affidavit is false and do not notify the transferee.[26] The Conference Report suggests that, in the case of publicly traded partnership interests sold by a foreign partner through a broker, the broker may deduct and withhold on behalf of the transferee.[27]

Congress has given the Treasury authority to prescribe a reduced amount to be withheld if the Treasury can determine that the withheld amount would not jeopardize the collection of tax under section 864(c)(8).[28]

If the transferee of a partnership interest fails to withhold the 10% tax, then the partnership is required to deduct and withhold from any distributions to the transferee a tax in an amount equal to the amount the transferee failed to withhold, with interest.[29]

2.3.Notice 2008-08

In Notice 2008-08, the Service noted stakeholders' indications that, in the case of dispositions of interests in publicly traded partnerships, applying section 1446(f) without guidance presents significant practical problems. For example, the transferee of an interest in a publicly traded partnership typically will not be able to determine whether any portion of a transferor partner's gain would be treated as ECI under section 864(c)(8), in part because the transferee may have no idea who is the seller. Moreover, while, as noted above, the legislative history anticipates that the government would provide guidance requiring a broker to deduct and withhold the tax, "until guidance is provided and new withholding and reporting systems are developed, it would not be possible for brokers to perform any such withholding."[30]

Responding to these concerns "and others raised by stakeholders", the government temporarily suspended the application of withholding to dispositions of publicly traded interests, but not to non-publicly traded interests, although the government did request comments on whether such a suspension should be provided. The Notice promised that the future guidance would be prospective and would include transition rules to allow sufficient time to prepare systems and processes for compliance.

2.4.Issues Arising Under Section 1446(f)

Many of the issues already noted with respect to the substantive provisions of section 864(c)(8) raise corresponding issues with respect to the implementation of section 1446(f). In addition, various issues arise directly under section 1446(f).

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[26] I.R.C. section 1446 (f)(2)(C) (referring to I.R.C. section 1445(d); see Treas. Reg. § 1.1445-4).

[27] H.R. Rep. No. 115-466, at 511 (2017).

[28] I.R.C. section 1446(f)(3).

[29] I.R.C. section 1446(f)(4).

[30] Notice 2018-08, *supra*, note 6.

As a general matter, the legislation seems to have taken some of its inspiration from section 1445 withholding but there are numerous practical differences. Numerous partnerships are engaged in a U.S. trade or business or may be deemed to be so engaged because of section 875. In many cases, the U.S. trade or business of these partnerships may constitute a small portion of their overall business. Avoiding overwithholding in these cases may be difficult or impossible if the process required to be followed is in any way similar to the process for obtaining a FIRPTA withholding certificate. FIRPTA withholding certificates take many weeks, and sometimes months, to obtain, and the kind of information that seems likely to be required under section 1446(f) in many cases will be much more complex than the relatively straightforward information needed to determine the maximum tax liability on disposition of a U.S. real property interest. The Service likely does not have the resources to handle a large volume of requests and it has not yet developed the necessary procedures and staff training that will be needed.

Further, the professional advisors involved in a typical U.S. real estate transaction are well aware of FIRPTA and withholding under section 1445. Many, if not most, partnerships that own U.S. real estate, do not have significant other assets and it is reasonable to expect them to be aware that there are substantive and withholding consequences to the sale of an interest in such a partnership. On the other hand, the taxpayers and the advisors in a transaction which may involve no U.S. parties and an interest in a non-U.S. partnership may have little or no reason to realize that a transaction may involve U.S. tax implications because of assets and activities that may be multiple tiers below the partnership being sold. The statute at least has no *de minimis* rules and we can only hope that the Service will consider promulgating such rules if it determines it has the authority to do so.

The following is a sampling of these issues:

- The tax under section 864(c)(8) is imposed on ECI, that is, net income or gain, but withholding is imposed on the amount realized. The amounts of tax and withholding will almost never be identical, ensuring that tax will always be over- or underwithheld. The amount required to be withheld is 10% of the entire proceeds of sale, regardless of the composition of the partnership's assets or the potential for there to be any ECI under section 864(c)(8). As a result, the amount required to be withheld may bear little or no relationship to the taxpayer's U.S. tax liability (if any) under section 864(c)(8).

- Section 1446(f) may be over-inclusive of transactions as well as amounts. Unlike section 864(c)(8), where it appears that the government will need to specify exceptions to nonrecognition treatment, section 1446(f) apparently requires withholding even in nonrecognition transfers of partnership interests. Section 864(c)(8)(E) provides authority to the Treasury to "such regulations or other guidance as the Secretary determines appropriate for the application of this paragraph, including with respect to exchanges described in section 332, 351, 354, 355, 356, or 361". However, there is no such specific authority provided with respect to the application of section 1446(f) to nonrecognition transactions, although one may

hope that the Service would exercise its general authority under section 1446(f)(3) to eliminate withholding in most nonrecognition transactions.[31]

- There are no de minimis exceptions in the statute. Many transactions involving dispositions of partnership interests are transactions that involve small amounts, generating revenue that do not appear to justify the compliance and administrative burdens required to collect it. The American Bar Association ("ABA") Section of Taxation has recommended consideration of an exception to be provided for cases in which the combined sale price of partnership interests being acquired by a single or related group of buyers is less than a particular amount, such as $500,000 or $1 million.[32]

- The transferor and the transferee may be unaware of whether any portion of the gain (if any) would in fact be treated as ECI and may not even know that the partnership is engaged in a U.S. trade or business.

- Even if the transferee is aware that the partnership is engaged in a U.S. trade or business, the transferee may be unable to determine whether the transferor partner is foreign or domestic, whether the transferor would recognize any gain, and how much of the gain (if any) would be ECI.[33] Indeed, in the middle of a tax accounting period, it would be even more difficult for the transferee to make these determinations. As a result, it would be burdensome for a transferee to determine whether it must withhold any amount under section 1446(f). As noted earlier, there is uncertainty on the treatment of partnership liabilities for the substantive purposes of section 864(c)(8) and it may be difficult or impossible for a transferee to ascertain the treatment or amount of liabilities. The ABA Section of Taxation comments suggest that transferees should be permitted to rely on certifications by the transferor or the partnership.

- Further complications arise in the case of tiered partnership arrangements. Where a transfer is made of an interest in a that itself is a partner of a second partnership, the transferee may have a very heavy, perhaps impossible, burden in determining whether the transferor would recognize any gain, and how much of the gain would be ECI. Moreover, if a foreign transferor sells and interest in a foreign partnership to a foreign transferee and the foreign partnership is in a structure that has a U.S. trade or business, it will in many cases be difficult

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[31] One may also wonder why the grant of authority makes specific reference to several corporate nonrecognition provisions but not, for example, to other nonrecognition provisions such as section 721(a) (contribution to U.S. partnership in exchange for partnership interest); section 731(a) (distribution by partnership); or even, arguably, section 643(e)(2) (amount of distribution where trust distributes property in kind).

[32] "American Bar Association Section of Taxation Comments on Need for Guidance Under Sections 864(c)(8) and 1446(f)" dated March 19, 2018 https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/031918comments.authcheckdam.pdf.

[33] *Ibid*. *See also* H.R. Rep. No. 115–466, *supra,* note 16.

to enforce a requirement for the foreign transferee, or the foreign partnership, to withhold tax equal to 10% of the amount realized in the transaction.

- The law is unclear as to how section 1446(f) interacts with other rules, such as the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) income tax withholding. If the partnership in question owns U.S. real property interests, and a 15% FIRPTA withholding tax may apply to some part of the amount realized by the transferor, presumably the FIRPTA withholding tax will apply instead of the section 1446(f) tax.

- The partnership audit rules of the Bipartisan Budget Act of 2015 became effective on January 1, 2018.[34] Under the Bipartisan Budget Act, the Service makes adjustments to "partnership items" at the partnership level in a single audit proceeding (as opposed to making adjustments for individual partners) and collects taxes at the partnership level. The new law does not state how it interacts with the partnership audit rules, including how an audit would handle the possibility of the partnership's secondary withholding tax and whether the partnership would be liable at the partnership level.

- It is unclear how section 1446(f) applies where proceeds are received by a partner in connection with a transaction treated as a disguised sale of a partnership interest. In a series of transactions where the transferor and transferee are not interacting with each other but with the partnership, who is liable for the withholding tax?

- The burden of secondary withholding tax on the partnership is also considerable and may cause overwithholding. The law does not explain how a partnership engaged in a U.S. trade or business may confirm that tax has been withheld on a transfer of a partnership interest or even how the partnership is supposed to know that a transfer has occurred, since transactions may be treated as dispositions for tax purposes without actually involving a transaction to which the partnership is a party or even of which it would normally be notified. For example, suppose a foreign company that had been classified as a corporation elects to be classified as a partnership. This would not necessarily come to the attention of a partnership in which the foreign company was a partner, even though the election might result in a taxable transaction under section 336(a).If the transferee fails to withhold and then transfers the acquired interest to another party, the law does not provide for the second transferee to be liable. Moreover, it is unclear whether the partnership would still be liable for the secondary withholding tax on distributions with respect to the partnership interest in question.

- The application of tax treaties is unclear. As in the case of the treatment of nonrecognition transactions, there appears to be no exception to the withholding requirement of section 1446(f) unless the Treasury provides an exception in guidance. At a minimum, we would hope that the Treasury will provide an exception from withholding where the partnership does not have a permanent establishment and the transferor certifies that it is entitled to the

[34] I.R.B. 2017-28.

benefit of an income tax treaty prohibiting the taxation of gain with respect to a (hypothetical) sale of partnership assets.

- The manner in which the partnership should withhold the secondary withholding tax is also unclear. For example, does the partnership simply withhold all of the distributions until the amount owed is met? Do other withholding requirements, including the rest of section 1446, take priority? How much time is the partnership allowed to withhold and deposit this tax?