

Regulations on Withholding on Foreign Partners Finalized

December 9, 2020

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Financial Executives Alliance
A First Republic Affinity Group

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Quick Background

**Foreign Partners
generally not subject
to tax in US on
capital gains**

30% WHT on US interest
and dividends



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Exception for ECI

E.g., gain on the sale of
business assets by
partnership portfolio
company

Foreign Partners
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Exception for ECI

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FIRPTA (US Real Estate Interests) Key Exception

Gain Deemed ECI



How We Got Here

1992 – Rev. Rul. 92-32 –
Gain on sale of
partnership interest =
ECI if partnership ETB

—————
Tax bar disagreed



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**2018 (Effective
November 2017) –
TCJA statutorily
overturned Grecian
Magnesite**

—————
1446(f) withholding



IRS Notice 2018-29

Instructions, calculations
and exemptions



How We Got Here – Almost Here

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Instructions, calculations
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2019 – Proposed Regulations

Limited certain
exemptions



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Instructions, calculations
and exemptions

2019 – Proposed Regulations

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October 2020 – Final Regulations



Withholding Requirement / Forms Practice

10% amount realized

Unless exception applies

Reliance on certificates







Approximately what percentage of commitments are from foreign LPs?

A) 0-10%

B) 10-20%

C) 20-40%

D) Over 40%



General Rules for All Certifications

Name and address of provider



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Exception for certification of withholding by transferee to partnership



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Electronic submission permissible

Email, image in email, PDF all ok (unless recipient knows transmitted by someone w/o authorization)



Determination Date

Information on certification must be as of the "determination date"

Same date must be used for all purposes w/respect to transfer

Must state the determination date on the certificate



What is the Determination Date? 3 Possibilities.

Date of transfer

Any date w/i 60 days
before transfer

Later of: (i) 1st day of
LP tax year of transfer
or (ii) most recent
reevaluation date

—————
Controlling partner
cannot use



Certificate of Non-Foreign Status

No withholding

Transferor provides

Must include name, TIN, address

Signed under penalties of perjury

W-9 sufficient

Rely on existing W-9 in possession



No Realized Gain

No withholding

Transferor provides to transferee

Transferee partnership relies on books and records

Must be no gain at all – tax deferred transfers separate

No 751 – May rely on partnership certificate

See general rules for additional contents



No withholding

Partnership provides to transferee

3 alternatives:

(i) Partnership not ETB any time during year of sale

(ii) On hypothetical sale of partnership *assets*

- no gain would be ECI or less than 10% *net* gain would be ECI or
- no (or less than 10%) distributive share of net ECI gain



No withholding

Partnership provides to transferee 3 alternatives:

- (i) Partnership not ETB any time during year of sale
- (ii) On hypothetical sale of partnership assets
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 - no (or less than 10%) distributive share of net ECI gain

Partnership transferee

No certificate: Partnership relies on books and records:

- (i) for year through date of transfer.
- (ii) as of determination date.







As a firm, will you provide the de minimis ECI gain certificate to transferring LPs (or if you are an advisor will you advise your client to provide the certificate)?

- A) Yes, where we are factually able to do so.

- B) No. We are against this generally.

- C) It depends on our relationship with the transferor/transferee partner.

- D) It depends on why the transferor partner cannot issue a different certificate.



De Minimis ECI

No withholding

Transferor provides to transferee

Partner throughout lookback period

Transferor's prior taxable year and 2 preceding that year

De Minimis rule

Less than \$1m ECI for *each* year of lookback; AND

Less than 10% of distributive gross income was ECI in *each* lookback year

ECI reported and tax paid



De Minimis ECI – Quirks, Glitches and Fixes

Cannot rely before K-1s issued for each period

Generally, no K-1 requirement for foreign partnerships

Late K-1 may preclude certificate

Removed 8805 requirement

No tacking of holding period



De Minimis ECI – Partnership as Transferee

Partnership relies on books and records

Representation regarding reporting/payment of tax required from transferor



Non-Recognition Transfer Certificate

Certificate that transferor will not recognize gain

Distinguish from no realized gain.

This result of non-recognition (e.g., 351)

Not available if only portion of gain not recognized (e.g., boot)



Treaty Certificate

Claim for exemption under treaty made on W-8 BEN or BEN-E

Must be mailed to IRS within 30 days *after* transfer

Cover letter requires transferor TIN

Generally a TIN is required to claim treaty benefits



Calculation of Amount Realized

**Cash paid
(or distributed by
partnership)**

Debt assumed

**Reduction in share of
liabilities**



Transferor Certificate of Liabilities

Transferor certificate of liabilities on most recent K-1

Controlling partner can't use

Certify no actual knowledge of events causing more than 25% difference

K-1 for last day of tax year less than 22 months before transfer



Partnership Certificate of Liabilities

Partnership certificate
of liabilities on
determination date

Controlling partner

Certify no actual
knowledge of events
causing more than 25%
difference

Absent transferor or
partnership certificate
and absent actual
knowledge, must
withhold

100%



Foreign Partnership's Modified Amount Realized

Amounts Realized

Multiplied by:

% gain allocable to
“presumed foreign
taxable persons”

As of
determination date



Certificate of Partnership's Modified Amount Realized

**Certificate by
transferor on W-8 IMY**

***Withholding
statement with W-9s
and treaty claims
attached***

**Claims for treaty
exemption mailed to
IRS**



Maximum Tax Liability Certificate

Transferor provides to transferee

Withhold ECI Gain x regular 1446 withholding rate

No application to IRS

Use this where only part of gain exempt under treaty or subject to non-recognition







Have you been requiring proof of adequate 1446(f) withholding as condition to transfer?

- A) No. The rules do not yet apply to partnership withholding.
- B) Yes. We require a copy of the 8288-A or other proof of withholding but rely on transferee as to amounts.
- C) Yes. We get proof AND review certificates of exemptions/reduced withholding prior to transfer.
- D) I don't know. I assume that my lawyers take care of that.



Notice to Partnership

**Within 10 days of
transfer**

**Include 8288-A
or state amount
realized and withheld**

**Include any
certificates supporting
exemptions/amounts
withheld**



BUT

The **transferee** remains liable for amounts under withheld if **partnership** knows/reason to know certification incorrect or unreliable



Partnership Withholding

Applicable to **transfers** after December 31, 2021

From distributions to transferee

100% until satisfied

Rely on certificate from transferee

Unless know or reason to know incorrect/unreliable

May rely on W-9 on hand

Facts on certificate differ from W-9 – deemed unreliable



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No withholding on distributions to new unrelated transferee



Amount of Withholding

100% until collect 10% amount realized

Amount realized solely under general rule

Cannot rely on the maximum liability

Must also collect interest amount



Withholding by Partnership Ends

Earlier of:

Collect all required

Receive the certification from transferee claiming exemption from withholding

Ok if certificate received late

Does not seem to permit maximum liability certificate



Failure to Withhold

Transferee/partnership liable

Tax

Penalties

Interest



No Harm No Foul?

Tax collected only once

Still liable for penalties / interest

Unless show **no** gain on transfer ECI

Penalties

Interest



Q & A



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Troutman Pepper Overview

Troutman Pepper is a national law firm known for its higher commitment to client care. With more than 1,100 attorneys in 23 U.S. cities, the firm partners with clients across every industry sector to help them achieve their business goals. Read more about the firm's litigation, transactional, and regulatory practices at troutman.com.

1,100+
combined
attorneys

23
U.S. cities

Top 10%
of all law firms for
innovative approach
and anticipating
client needs.

– BTI Client Service A-Team 2018 list

47th
projected
Am Law
ranking



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