STRADLEY RONON

Tax Insights

A Publication of the Stradley Ronon
Tax Practice Group

WWW.STRADLEY.COM

OCTOBER 15, 2020

Stradley Ronon Stevens & Young, LLP
2005 Market Street
Suite 2600
Philadelphia, PA 19103-7018
215.564.8000 Telephone
215.564.8120 Facsimile
www.stradley.com

With other offices in:
Washington, D.C.
New York
New Jersey
Illinois
Delaware

IRS Issues Final Regulations Regarding Withholding on Foreign Partners

The IRS has issued final regulations (TD 9926) clarifying withholding requirements for foreign persons who sell or transfer their interest in a partnership conducting a U.S. trade or business. Effective for sales, exchanges and other dispositions after Dec. 31, 2017, Section 1446(f)(1) provides that if a portion of the gain (if any) on any disposition of an interest in a partnership would be treated as effectively connected with the conduct of a trade or business within the U.S., the transferee is required to deduct and withhold a tax equal to 10% of the amount realized on the disposition. Generally, Section 864(c)(8) provides that gain or loss from the transfer of an interest, owned directly or indirectly, in a partnership that is engaged in any trade or business within the U.S is treated as effectively connected (EC) gain or loss. (Section references are to the Internal Revenue Code of 1986, as amended.)

In May 2019, the IRS released proposed regulations (REG-105476-18) (see our coverage here) relating to the withholding of tax and information reporting (the proposed regulations) with respect to certain dispositions by a foreign person of an interest in a partnership that is engaged in a trade or business within the U.S. or a partnership that owns, directly or indirectly, an interest in a partnership so engaged. In general, the proposed regulations provided rules that apply to transfers of interests in non-publicly traded partnerships and transfers of publicly traded partnerships. The final regulations retain the basic approach and structure of the proposed regulations with certain revisions based on comments received. For example, in response to the comments, the final regulations provide that any person required to withhold under Section 1446(f) is not liable for failure to withhold, or any interest, penalties, or additions to tax if that person establishes to the IRS's satisfaction that the transferor had no gain subject to tax on the transfer.

The final regulations modify certain exceptions to withholding. For example, the proposed regulations provided an exception to withholding if a transferee relies on a transferor's certification that the transfer of the partnership interest would not result in any realized gain (the No Gain Exception). The final regulations modify the No Gain Exception to add that a transferor may rely on a partnership's certification that the transfer of the partnership interest would not result in any ordinary income. In response to a comment noting that the proposed regulations did not provide an exception to withholding for a transfer that would not be subject to Section 864(c)(8) because the partnership is not engaged in a trade or business in the U.S (non-USTB partnership), the final regulations provide that a transferee may rely on a partnership's certification stating that the partnership was a non-USTB partnership during the period beginning on the first day of the partnership's tax year in which the transfer occurs and ending on the close of the date of transfer.

IRS Issues Final Regulations on ABLE Accounts

The IRS has released final regulations (TD 9923) that provide guidance on the requirements a program must satisfy to be considered a qualified ABLE program under Section 529A, the requirements for establishing an ABLE account, as well as other issues. The final regulations adopt prior proposed regulations with modifications. For example, consistent with Section 529A(b)(1), which defines an ABLE program as a program "established and maintained" by a State, the final regulations provide that a program is established by a State if the program is initiated by State statute or regulation or by an act

of a State official or agency with the authority to act on behalf of the State. The final regulations set forth factors that are relevant in determining whether a State is actively involved in the administration of the program. A program is maintained by a State if all the terms and conditions of the program are set by the State, and the State is actively involved on an ongoing basis in the administration of the program. Additionally, prior proposed regulations provided that a qualified ABLE program may not allow the designated beneficiary of an ABLE account to direct, either directly or indirectly, the investment of any contributions to his or her account (or any earnings thereon) more often than twice in any calendar year (investment direction limitation). The final regulations clarify that an investment direction limitation does not include the transfer of account assets from the investment portion of an ABLE account to a money market account or similar vehicle maintained by the qualified ABLE program to process a requested distribution. The final regulations also provide that an automatic rebalancing of the assets in an ABLE account merely to maintain a particular asset allocation is not a change in investment direction and, therefore, is an exception to the investment direction limitation.

IRS Issues Final Rehabilitation Tax Credit Regulations

IRS has issued final regulations (TD 9915) under Section 47 to address changes made by the 2017 Tax Cuts and Jobs Act that limit the credit to certified historic structures. The regulations address the operation of credit allocation as well as provide various definitions.

IRS Provides Update Regarding Micro-Captive Insurance Arrangements

The IRS issued News Release 2020-226, in which it updated information on its enforcement efforts with respect to micro-captive insurance transactions. In general, a micro-captive insurance transaction is a transaction in which a taxpayer attempts to reduce the aggregate taxable income of the taxpayer, related persons, or both, using contracts that the parties treat as insurance contracts and a related company that the parties treat as a captive insurance company. Each entity that the parties treat as an insured entity under the contracts claims deductions for premiums for insurance coverage. The related company that the parties treat as a captive insurance company elects under Section 831(b) to be taxed only on investment income and therefore excludes the payments directly or indirectly received under the contracts from its taxable income. The IRS previously concluded that certain micro-captive insurance transactions had the potential for tax avoidance and evasion and notified taxpayers that these transactions were "transactions of interest" that need to be disclosed to the IRS. The IRS recently announced that it would significantly increase enforcement activity around micro-captive insurance transactions.

Christopher C. Scarpa **Jacquelyn Gordon**

For more information, contact Christopher C. Scarpa at 215.564.8106 or cscarpa@stradley.com or Jacquelyn Gordon at 215.564.8176 or jgordon@stradley.com.

In the News Release, the IRS encourages any taxpayer who has continued to engage in an abusive micro-captive insurance transaction not to anticipate being able to settle its transaction with the IRS on terms more favorable than those contained in previously announced settlement offers and that any potential future settlement initiative that the IRS may consider will require additional concessions by the taxpayer. The IRS encourages taxpayers who participated in a micro-captive insurance transaction to consult an independent tax advisor and consider exiting the transaction and not claiming deductions associated with it. For those taxpayers who do not exit the transaction and continue taking such deductions, the IRS will disallow tax benefits from transactions that are determined to be abusive. They may also require domestic captives to include premium payments in income and may assert a withholding liability related to foreign captives. The IRS will also assert penalties, as appropriate.

IRS Adds New Compliance Campaigns

The IRS Large Business and International Division (LB&I) has added compliance campaigns on consolidated net operating loss limitations and nonresident alien rental income from U.S. property.