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Electing Out of IRS Centralized Partnership Audit Regime

The IRS issued final regulations (T.D. 9829 (https://www.gpo.gov/fdsys/pkg/FR-2018-01-02/pdf/2017-28398.pdf)) regarding the election out of the centralized partnership audit regime rules. The final regulations are effective for partnership tax years that begin after Dec. 31, 2017. The final regulations generally follow proposed regulations that were issued in June 2017 (see our prior coverage here (http://www.stradley.com/insights/publications/2017/06/tax-insights-june-14-2017)). The minor changes reflected in the final regulations include the following:

- Section 301.6221(b)-1(b) of both the proposed and final regulations provides that only an eligible partnership may elect out of the centralized partnership audit regime. A partnership is an eligible partnership if it has 100 or fewer partners during the year and, if at all times during the tax year, all partners are eligible partners. Section 301.6221(b)-1(b)(3)(ii) of the regulations sets out which partners are not eligible partners. Under the proposed regulations, one category of partner that is not an eligible partner was "a nominee or other similar person that holds an interest on behalf of another person." The final regulations modify this language so that it now reads "any person that holds an interest in the partnership on behalf of another person."

- Section 301.6221(b)-1(c)(2) of both the proposed and final regulations provides that partnerships making an election out must disclose to the IRS information about each person that was a partner at any time during the tax year of the partnership to which the election applies. Where a partner was an S corporation, the proposed regulations required that the information be provided with respect to "each shareholder of the S corporation." The final regulations clarify this rule by providing that, as part of a valid election, a partnership must disclose the required information about each person who was a shareholder in the S corporation partner at any time during the tax year of the S corporation ending with or within the partnership's tax year.

- Section 301.6221(b)-1(c)(3) of both the proposed and final regulations provides that a partnership that makes an election out must notify each of its partners of the election within 30 days of making the election. The final regulations provide that this notification may be made in the form and manner determined by the partnership.

IRS Issues Guidance on Deemed Repatriation Rules in Tax Cuts and Jobs Act

The IRS has issued Notice 2018-07, 2018-4 IRB (https://www.irs.gov/pub/irs-drop/n-18-07.pdf) and News Release 2017-212 (https://www.irs.gov/newsroom/irs-issues-guidance-on-transition-tax-on-foreign-earnings) providing guidance regarding Section 965, which was enacted into law by the Tax Cuts and Jobs Act (Act) and which requires certain foreign corporations to increase their subpart F income, for their last tax year that begins before Jan. 1, by the amount of their deferred foreign income. (Section references are to the Internal Revenue Code of 1986, as amended (the Code).)

Taxpayers may rely on the guidance in this notice, which includes examples, until the IRS issues regulations. The new regulations will be effective beginning in a foreign corporation's first tax year to which Section 965 applies.

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In general, Section 965 imposes a tax on untaxed foreign earnings of U.S. companies' foreign subsidiaries by deeming those earnings repatriated. Under the new law, foreign earnings held in cash and cash equivalents are taxed at a 15.5 percent rate. The remaining earnings are taxed at an 8 percent rate. Generally, the transition tax may be paid in installments over an eight-year period. Section 965 is effective for the last tax years of foreign corporations that begin before Jan. 1, 2018. Also, it applies to U.S. shareholders for tax years in which or with which such foreign corporations' tax years end.

IRS Suspends Withholding on Effectively Connected Gain on Disposition of Partnership Interest

The IRS issued Notice 2018-08, 2018-4 IRB (https://www.irs.gov/pub/irs-drop/n-18-08.pdf) announcing that, pending further guidance, it is suspending withholding obligations under Section 1446(f) with respect to certain publicly traded partnership interests. The Act added Section 1446(f) to the Code. The suspension does not extend to new Section 864(c)(8), as added by the Act, which provides the extent to which a nonresident alien individual's or foreign corporation's gain or loss from the sale, exchange or other disposition of a partnership interest is effectively connected with the conduct of a U.S. trade or business.

Under pre-Act law, the IRS's position in Revenue Ruling 91-32, 1991-1 CB 107 (http://www.ilw.com/books/TheEB5BookOnlineResource/Regulations/Revenue-Rule-91-32.shtm) was that gain or loss of a foreign partner from a disposition of an interest in a partnership that conducts a trade or business through a fixed place of business or that has a permanent establishment in the U.S. is treated as gain or loss effectively connected with the U.S. trade or business or is gain or loss attributable to the permanent establishment. However, in *Grecian Magnesite Mining, Industrial & Shipping Co.* (https://www.ustaxcourt.gov/USTCInOP/OpinionViewer.aspx?ID=11322), 149 T.C. No. 3 (2017), the U.S. Tax Court rejected the IRS's position and held that a foreign corporation's gain on the sale of an interest in a partnership that engaged in a U.S. trade or business was not U.S.-source income and was not effectively connected with a U.S. trade or business.

Under Section 864(c)(8), as added by the Act, a nonresident alien individual's or foreign corporation's gain or loss from the sale, exchange or other disposition of a partnership interest is effectively connected with the conduct of a trade or business in the U.S. to the extent that the person would have had effectively connected gain or loss had the partnership sold all its assets at fair market value. Section 864(c)(8) applies to sales, exchanges or other dispositions occurring on or after Nov. 27, 2017.

Section 1446(f)(1), as added by the Act, provides that if any portion of the gain 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 U.S. (i.e., "effectively connected gain"), then the transferee must withhold a tax equal to 10 percent of the amount realized on the disposition.

To allow for an orderly implementation of Section 1446(f) requirements, the IRS has determined, in Notice 2018-8, that withholding under Section 1446(f) should not be required with respect to any disposition of an interest in a publicly traded partnership (within the meaning of Section 7704(b)) until regulations or other guidance have been issued under Section 1446(f). The temporary suspension of withholding is limited to dispositions of interests that are publicly traded and does not extend to nonpublicly traded interests.

The IRS intends to issue future regulations or other guidance on how to withhold, deposit and report the tax withheld under Section 1446(f) with respect to a disposition of an interest in a publicly traded partnership.

In the case of a disposition of a publicly traded partnership interest, applying new Section 1446(f) without guidance presented significant practical problems. For example, a transferee of an interest in a publicly traded partnership typically would not be able to determine whether the transferor partner was foreign or domestic or whether any portion of a transferor partner's gain would be treated under new Section 864(c)(8) as effectively connected gain. This might be the case because publicly traded partnership interests were generally held in street name by a broker and transferred through a clearinghouse. Further, a particular sale might be aggregated with other sales and purchases of partnership interests by other customers of the same broker. As a result, it might be difficult for a transferee to determine whether it was required to withhold under Section 1446(f).

Although the Conference Report for the Act suggested that the IRS issue guidance providing that, in the case of a publicly traded partnership interest sold by a foreign partner through a broker, the broker may deduct and withhold on behalf of the transferee, pending the provision of such guidance and the development of new withholding and reporting systems, brokers cannot perform any such withholding.

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