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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 Defers Application of Foreign Partnership Withholding Regs

The IRS, in Notice 2021-51, announced its intent to amend the regulations under Section 1446(a) and 1446(f) to defer the applicability date from Jan. 1, 2022 to Jan. 1, 2023 for the following: (i) withholding on distributions made with respect to interests in publicly traded partnerships (PTP interests) under Section 1446(a); (ii) withholding on transfers of PTP interests under Section 1446(f) and (iii) withholding by partnerships on distributions to transferees under Section 1446(f)(4). (Section references are to the Internal Revenue Code of 1986, as amended.) The final regulations, issued in 2020 (see our prior coverage here), clarify withholding requirements for foreign persons who sell or transfer their interest in a partnership conducting a U.S. trade or business. Generally, Section 1446(a) requires a partnership that has effectively connected taxable income, any of which is allocable to a foreign partner, to pay a withholding tax. 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. Both Sections 1446(f) and 864(c)(8) were added by the 2017 Tax Cuts and Jobs Act.

For transfers and distributions that occur on or after Jan. 1, 2022, the final regulations (a) described withholding and reporting requirements applicable to brokers effecting transfers of PTP interests on behalf of foreign persons; (b) modified certain rules which previously permitted only a PTP or a U.S. person to be the withholding agent, to allow a qualified intermediary (or a U.S. branch treated as a U.S. person) to assume withholding on distributions with respect to PTP interests; (c) provide that a qualified intermediary that assumes withholding on a distribution under section 1446(a) must also assume withholding on the distribution under section 1446(f) and (d) provided rules for withholding and reporting by partnerships (other than publicly traded partnerships) making distributions to transferees of partnership interests who failed to withhold as required under section 1446(f)(1).

The U.S. Department of the Treasury and the IRS intend to amend certain applicability dates of the final regulations to provide that the provisions relating to withholding and reporting on transfers of PTP interests under section 1446(f)(1) will apply to transfers that occur on or after Jan. 1, 2023, and amend the applicability date of the modifications to Treas. Reg. Section 1.1446-4 listed in Treas. Reg. Section 1.1446-7 to apply to distributions with respect to PTP interests made on or after Jan. 1, 2023.

IRS Releases Process Unit on Transfers of Property to Partnerships With a Related Foreign Partner

The IRS has released a process unit on the transfers of property to partnerships with a related foreign partner under Section 721(c). Generally, contributions to partnerships of property with a built-in gain generally are not taxable events to partners under Section 721(a). However, Section 721(c) grants the IRS authority to issue Treasury regulations

that provide that Section 721(a) will not apply to gain realized on the transfer of property to a partnership (domestic or foreign) if the gain, when recognized, would be includible in the gross income of a person other than a U.S. person. Such regulations were released in Jan. 2020. (See our coverage here.) The Section 721(c) regulations generally provide that a U.S. transferor must recognize gain upon the transfer of appreciated property (tangible or intangible property) to certain partnerships (domestic or foreign) whose partners include foreign persons related to the U.S. transferor unless certain requirements are met. Specifically, the U.S. transferor will immediately recognize gain unless it elects to apply the gain deferral method, which generally allows the U.S. transferor to recognize the pre-contribution gain over time (except in certain instances where it may be accelerated). Therefore, when a U.S. transferor contributes appreciated property to partnerships with foreign partners who are related to the transferor, the normal non-recognition provisions of Section 721(a) are disregarded unless the gain deferral method applies. The process unit goes through the following steps to help a taxpayer determine what the appropriate tax treatment should be in the case of the contribution by a U.S. transferor of appreciated property to a partnership that has a related foreign partner: (1 determine if there is a contribution of Section 721(c) property; (2) determine if the contribution is to a Section 721(c) partnership; (3) determine if the five requirements of the gain deferral method are met; and, (4) determine if the partnership adopted both the remedial allocation method and the consistent allocation method.

IRS Issues Interim Guidance for TEFRA Partnership Examinations

The IRS's Large Business and International Division issued a memorandum to employees regarding interim guidance for TEFRA partnership examinations with issues under Section 965, which deviates from the IRM. Section 965 was added by the 2017 Tax Cuts and Jobs Act and generally requires certain U.S. shareholders of certain specified foreign corporations that have untaxed foreign earnings and profits to pay a tax as if those earnings and profits have been repatriated to the U.S. Section 965 applies to the last taxable year of the relevant specified foreign corporation that begins before Jan. 1, 2018, and the amount included in income under Section 965 is includible in the U.S. shareholder's year in which or with which such a specified foreign corporation's year ends. A TEFRA partnership is any partnership in the 2017 tax year or prior that either elected to be a TEFRA partnership or did not meet the small partnership exception to TEFRA and did not make an early election into the new partnership audit regime. Specifically, the guidance (1) provides authority to allow the Section 6501(a) three-year statute of limitations to expire on investor returns where Section 965(k) provides for a six-year statute of limitations on assessment of the Section 965 net tax liability and (2) applies to all TEFRA partnership cases within the Section 965 Campaign, Section 965 for Individuals Campaign and in limited circumstances and only where specifically indicated any other cases where available information indicates a TEFRA partnership or an investor incorrectly calculated the Section 965 net tax liability or failed to report a Section 965 inclusion, deduction, or tax. The guidance should be incorporated into IRM 4.31.2, TEFRA Examinations – Field Office Procedures.

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.

NY Issues Guidance on PTET

The New York State Department of Taxation and Finance has issued a technical memorandum that discusses the new optional pass-through entity tax (PTET) that partnerships or New York S corporations may elect to pay. If an eligible partnership or New York S-corporation elects to pay PTET, its partners, members or shareholders may be eligible for a PTET credit on their New York State income tax returns. The technical memorandum discuss which entities may make the election, when the election has to be made, how to calculate the tax and make the necessary filings under the law.