Hon. Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments on Proposed Regulations under Section 1446(f)

Dear Commissioner Rettig:

Enclosed please find comments on the proposed regulations under section 1446(f) of the Internal Revenue Code. These comments are submitted on behalf of the Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss these comments with you or your staff.

Sincerely,

Eric Solomon
Chair, Section of Taxation

Enclosure

cc: Hon. David Kautter, Assistant Secretary (Tax Policy), Department of the Treasury
    Lafayette G. "Chip" Harter III, Deputy Assistant Secretary (International Tax Affairs), Department of the Treasury
    Krishna P. Vallabhaneni, Tax Legislative Counsel, Department of the Treasury
    Doug Poms, International Tax Counsel, Department of the Treasury
    Brett York, Associate International Tax Counsel, Department of the Treasury
    Hon. Michael Desmond, Chief Counsel, Internal Revenue Service
    William M. Paul, Deputy Chief Counsel (Technical), Internal Revenue Service
    Peter Blessing, Associate Chief Counsel (International), Internal Revenue Service
    Holly Porter, Associate Chief Counsel (Passthroughs & Special Industries), Internal Revenue Service
    Daniel M. McCall, Deputy Associate Chief Counsel (International), Internal Revenue Service
AMERICAN BAR ASSOCIATION SECTION OF TAXATION  
COMMENTS ON PROPOSED REGULATIONS UNDER SECTION 1446(f)

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation (the “Section”) and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Michael J. Miller of the Section’s U.S. Activities of Foreigners and Tax Treaties Committee (the “Committee”). Substantial contributions also were made by Amit M. Sachdeva, Alan T. Cathcart, Jairo G. Cano, and Marina Vishnepolskaya. Helpful comments also were made by Robert Kantowitz, Michael J.A. Karlin, and Fred F. Murray. The Comments were reviewed by Summer A. LePree, the Chair of the Committee, and by Edward Tanenbaum of the Section’s Committee on Government Submissions, and Eric B. Sloan, the Section’s Vice Chair for Government Relations.

Although members of the Section of Taxation may have clients who might be affected by the federal tax principles addressed by these Comments, no member who has been engaged by a client (or who is a member of a firm or other organization that has been engaged by a client) to make a government submission with respect to, or otherwise to influence the development or outcome of one or more specific issues addressed by, these Comments has participated in the preparation of the portion (or portions) of these Comments addressing those issues. Additionally, while the Section’s diverse membership includes government officials, no such official was involved in any part of the drafting or review of these Comments.

Contact: Michael J. Miller  
(212) 903-8757  
miller@rhtax.com

Date: July 10, 2019
I. BACKGROUND

Following the Tax Court’s rejection of Rev. Rul. 91-32\textsuperscript{1} in *Grecian Magnesite Mining Co. v. Commissioner*,\textsuperscript{2} new Sections 864(c)(8) and 1446(f) were enacted as part of the 2017 Tax Act (the “Act”).\textsuperscript{3}

Section 864(c)(8) generally provides that, subject to certain limitations, gain or loss derived by a nonresident alien or foreign corporation upon the disposition of an interest in a partnership that is engaged in any trade or business within the United States (“ETBUS”) is treated as effectively connected with the conduct of such U.S. trade or business (“ECI”).

Section 1446(f)(1) provides that, if any portion of the gain (if any) on a disposition of an interest in a partnership would be treated as ECI under Section 864(c)(8) (“Section 864(c)(8) ECI”), the transferee of the partnership interest must withhold tax equal to 10% of the amount realized on the disposition. However, pursuant to Section 1446(f)(2), withholding is not required if the transferor furnishes to the transferee an affidavit stating, under penalty of perjury, the transferor’s taxpayer identification number and that the transferor is not a foreign person.

Section 1446(f)(3) permits the Secretary to prescribe a reduced amount of withholding at the request of the transferor or transferee if the Secretary determines that such reduction will not jeopardize the collection of tax imposed on Section 864(c)(8) ECI. Section 1446(f)(6) directs the Secretary to issue such regulations or other guidance as may be necessary to carry out the purposes of Section 1446(f), including regulations providing for exceptions from the provisions of that subsection.

Section 1446(f)(4) provides that, if the transferee fails to withhold as required under Section 1446(f), a secondary withholding obligation is imposed on the partnership. Finally, Section 1446(f)(5) provides that any term used in Section 1446(f) and also Section 1445 shall have the same meaning as when used in Section 1445.

The Department of the Treasury (“Treasury”) and the Internal Revenue Service (the “Service”) issued guidance under Section 1446(f) in Notice 2018-84 and Notice 2018-29.\textsuperscript{5} On May 7, 2019, Treasury issued proposed regulations under Section 1446(f) (the “Proposed Regulations”).

We appreciate the efforts of Treasury and the Service to balance the interests of taxpayers and the government in drafting the Proposed Regulations.

\textsuperscript{1} 1991-1 C.B. 107.
\textsuperscript{2} 149 T.C. No. 3 (July 13, 2017), aff’d, 123 AFTR 2d 2019-XXXX, (D.C. Cir.) (June 11, 2019).
\textsuperscript{3} An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. No. 115-97, 131 Stat. 2054 (2017) (the “Act”). References to a “Section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.
II. EXECUTIVE SUMMARY

The Proposed Regulations generally require each transferee of a partnership interest to withhold 10% of the amount realized by the transferor on the transfer of the interest. The Proposed Regulations provide two exceptions from this withholding obligation. First, the transferee generally is not required to withhold if it receives, and relies on, any of six types of certification from the transferor or the partnership. Second, a partnership that is the transferee by reason of making a distribution to the transferor also is generally not required to withhold if it relies on its books and records to determine that (i) the transferor would realize no gain on the distribution, (ii) upon a hypothetical sale of all of the partnership’s assets for fair market value, less than 10% of the total net gain would be ECI, or (iii) in each of the three preceding years the transferor was a partner in the partnership and during such period less than 10% of the transferor’s total distributive share of net income was effectively connected taxable income (“ECTI”) (provided certain additional requirements are satisfied).

If neither exception applies, nothing in the Proposed Regulations expressly relieves the transferee of a partnership interest from the obligation to withhold, even if, under the Code, withholding is not required.

If a transferee fails to withhold the amount required, the partnership must withhold from distributions to the transferee. The transferee is required to provide a certification to the partnership stating the amount realized and justifying the amount (if any) withheld under Section 1446(f)(1), and the partnership is required to review such certification. If the partnership determines the certification to be incorrect or unreliable, it must withhold under Section 1446(f)(4), even if such determination is based on information that was not available to the transferee and even if the transferee acted properly in either not withholding or determining the amount to withhold. Even if the partnership considers the certification from the transferee to be correct and reliable, it “may” rely on such certification, or it may nevertheless choose to withhold on distributions to the transferee under Section 1446(f)(4).

Our recommendations are as follows:

1. We recommend that the final regulations confirm that, regardless of whether either of the two exceptions cited above is availed of, a transferee will not be considered to have failed to withhold under Section 1446(f) if the transferee (or the partnership) can demonstrate any of the following:

---

6 Prop. Reg. §1.1446(f)-2(a). A different set of rules is proposed to apply to transfers of interests in publicly traded partnerships that are effected through a broker. See Prop. Reg. §1.1446(f)-4.

7 See Prop. Reg. §1.1446(f)-2(b)(1) – (7).

8 See Prop. Reg. §1.1446(f)-2(b)(3)(ii), (4)(ii) and (5)(v).

9 Prop. Reg. §1.1446(f)-3(a)(1).

10 Prop. Reg. §§1.1446(f)-2(d)(2) and 1.1446(f)-3(a)(1).

a. the transferor realized no gain (and no ordinary income under Section 751) in connection with such transfer;

b. none of the gain (and none of the ordinary income under Section 751), if any, realized by the transferor in connection with such transfer was Section 864(c)(8) ECI;

c. pursuant to a nonrecognition provision, none of the Section 864(c)(8) ECI realized in connection with such transfer was recognized; or

d. the transferor is not a foreign person.

2. As an alternative to our first recommendation, we recommend that the final regulations provide an exception for any transfer of an interest in a partnership if the transfer of such interest in a fully taxable disposition could not give rise to section 864(c)(8) ECI, e.g., if the partnership is a “Never ETBUS Partnership,” as defined below.

3. We recommend that the final regulations provide that secondary withholding under section 1446(f)(4) is neither required nor permitted in the case of distributions to “Fully Compliant Transferees,” as defined below.

III. Discussion

A. Primary Withholding

Section 1446(f)(1) 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, the transferee shall be required to deduct and withhold a tax equal to 10 percent of the amount realized on the disposition.”

It is clear from the Proposed Regulations and the preamble thereto that the obligation to withhold under section 1446(f)(1) applies only if the transferor of a partnership interest realizes a gain (or realizes ordinary income under section 751) on the disposition, all or a portion of the recognized gain (or ordinary income) is section 864(c)(8) ECI, and all or a portion of such section 864(c)(8) ECI is recognized. Thus, for example, it seems clear that section 1446(f) withholding is never required upon the disposition of an interest in a partnership that never has been ETBUS (a “Never ETBUS Partnership”).

Furthermore, while section 1446(f)(1) does not explicitly say so, section 1446(f) withholding is required only if the partnership interest that is transferred is directly or indirectly owned by a foreign person. Pursuant to section 864(c)(1), sections 864(c)(2) through (8) apply solely “[i]n the case of a nonresident alien or foreign corporation engaged in a trade or business within the United States during the taxable year.” Similarly, section 864(c)(8) applies by its terms to treat gain on the disposition an interest in a partnership as ECI only “if a nonresident alien individual or foreign corporation” directly or indirectly owns such interest. Since the recognition of section 864(c)(8) ECI by the transferor is a prerequisite to the application of section 1446(f)(1), and only a foreign person can recognize Section 864(c)(8) ECI, section 1446(f)(1) cannot apply
where the partnership interest that is transferred is not owned, directly or indirectly by a foreign person.12

However, as written, the Proposed Regulations appear to require a transferee to withhold in a number of circumstances where Section 1446(f)(1) does not. The Proposed Regulations generally provide that, unless an exception applies, “a transferee is required to withhold under Section 1446(f)(1) a tax equal to 10 percent of the amount realized on any transfer of a partnership interest.”13 The Proposed Regulations provide two exceptions from this withholding obligation.

First, the Proposed Regulations provide a “Certification Exception” pursuant to which the transferee is not required to withhold if it receives, and relies on, any of six types of certification from the transferor or the partnership (each, a “Specified Certification”), provided it does not have actual knowledge that such certification is incorrect or unreliable.14 In very general terms, the Specified Certifications are as follows:

- Certification from the transferor that the transferor is not a foreign person.15
- Certification from the transferor that the transfer would not result in the realization of any gain (including ordinary income under Section 751) by the transferor as of the applicable determination date.16
- Certification from the partnership that, upon a hypothetical sale of all of the partnership’s assets for fair market value, the amount of net gain from such sale that would be ECI would be less than 10% of the total net gain from such sale.17
- Certification from the transferor that less than 10% (but not zero) of the transferor’s distributive share of the partnership’s income for each year during a specified three-year period was ECTI, and also certifying as to certain additional requirements.18

---

12 We note that that section 1446(f)(1) could potentially apply to certain transfers of partnership interests by domestic partnerships with foreign partners, but in such cases the transferor domestic partnerships would be required to withhold under section 1446(a) and, in our view, there is no need to impose section 1446(f) withholding as well. Indeed, the Proposed Regulations already reflect this approach. See Prop. Reg. §1.1446(f)-2(b)(2) (generally permitting the transferee to not withhold if the transferor provides a certification of non-foreign status, with no exception prohibiting domestic partnerships with foreign partners from providing such certification).

13 Prop. Reg. §1.1446(f)-2(a).

14 Prop. Reg. §1.1446(f)-2(b)(1).

15 Prop. Reg. §1.1446(f)-2(b)(2).


18 Prop. Reg. §1.1446(f)-2(b)(5). The certification must also state, among other things, that the ECTI allocable to the transferor for each year during such period was less than $1,000,000 and was reported on a U.S. federal income tax return. Prop. Reg. §1.1446(f)-2(b)(5)(B) and (D). The certification generally may be made only if, for each year during the applicable three-year period, the transferor received Form 8805. Prop. Reg. §1.1446(f)-2(b)(5)(iii).
• Certification from the transferor that, pursuant to a nonrecognition provision, the transferor is not required to recognize any gain on the transfer.19
• Certification from the transferor that the transferor is exempt from tax on all of the gain from the transfer under a U.S. income tax treaty.20

Second, the Proposed Regulations provide a “Partnership Books and Records Exception” pursuant to which a partnership that is a transferee by reason of making a distribution to the transferor need not withhold if the partnership relies on its books and records (provided it neither knows nor has reason to know that the information therein is incorrect or unreliable) to determine any of the following:

• The transfer would not result in the realization of any gain to the transferor as of the applicable determination date.21
• Upon a sale of all of the partnership’s assets for fair market value, the amount of net gain from that sale that would be ECI would be less than 10% of the total net gain from that sale.22
• Less than 10% of the transferor’s distributive share of the partnership’s income for each year during a specified three-year period was ECTI, and also certifying as to certain additional requirements.23

In any instance in which neither the Certification Exception nor the Partnership Books and Records Exception applies, nothing in the Proposed Regulations expressly provides any relief from the generally applicable obligation to withhold on all transfers of partnership interests in situations in which section 1446(f)(1) withholding would not be required. The Proposed Regulations’ apparent imposition of such a withholding obligation is, in our view, overly broad and, we assume, was not intended.24

In order to more clearly conform the Proposed Regulations with the limitations that are inherent in section 1446(f)(1), we recommend that the final regulations confirm that, even if neither the Certification Exception nor the Partnership Books and Records Exception applies, the

---

19 Prop. Reg. §1.1446(f)-2(b)(6). This exception does not apply where a portion, but not all, of the gain realized on the transfer of the partnership interest is subject to a nonrecognition provision. See Prop. Reg. §1.1446(f)-2(c)(4)(v) for rules applicable to such transactions.
20 Prop. Reg. §1.1446(f)-2(b)(7). This exception does not apply where a portion, but not all, of the gain realized on the transfer of the partnership interest is eligible for tax treaty benefits. See Prop. Reg. §1.1446(f)-2(c)(4)(vi) for rules applicable to such transactions.
21 Prop. Reg. §1.1446(f)-2(b)(1) and (3)(ii).
22 Prop. Reg. §1.1446(f)-2(b)(1) and (4)(ii).
23 Prop. Reg. §1.1446(f)-2(b)(5)(v). The partnership must also determine, among other things, that the ECTI allocable to the transferor for each year during such period was less than $1,000,000 and must also obtain a representation from the transferor to the effect that its allocable share of ECTI was reported on a U.S. Federal income tax return.
24 In this regard, we note that section 1446(f)(6) does not appear to provide regulatory authority to require withholding where the conditions set forth in section 1446(f)(1) are not satisfied.
transferee will not be considered to have failed to withhold under section 1446(f) if the transferee (or the partnership) can demonstrate any of the following:

1. the transferor realized no gain (and no ordinary income under section 751) in connection with such transfer;
2. none of the gain (or ordinary income under section 751) realized by the transferor in connection with such transfer was treated as section 864(c)(8) ECI;
3. pursuant to a nonrecognition provision, none of the section 864(c)(8) ECI realized in connection with such transfer was recognized; or
4. the transferor was not a foreign person at the time of the transfer.25

Of course, confirmation of the above would not eliminate the incentive of the transferee to obtain (if possible) one of the six Specified Certifications (or, in the case of a partnership, to take advantage of the Partnership Books and Records Exception) described in the Proposed Regulations. A transferee who properly applies the Certification Exception or the Partnership Books and Records Exception has fulfilled the transferee’s withholding obligations under section 1446(f)(1), even if the certification or other information relied upon ultimately proves to be incorrect. A transferee who does not rely upon either the Certification Exception or the Partnership Books and Records Exception would be protected only if such transferee otherwise were able to demonstrate adequately one of the four propositions above.

If Treasury and the Service do not accept our first recommendation, as set forth above, we recommend, in the alternative, that the final regulations provide an exception for any transfer of an interest in a partnership if it is demonstrated that the transfer of such partnership interest in a fully taxable disposition could not trigger section 864(c)(8) ECI. To take the most obvious example of such a scenario, the exception would apply to every disposition of an interest in a Never ETBUS Partnership (a “Never ETBUS Partnership Interest”).

The exception should also apply if the transferee (or the partnership) can demonstrate that (1) upon a hypothetical sale of all of the partnership’s assets at a gain on the date of the transfer, none of the income or gain arising from such sale would be Section 864(c)(8) ECI, (2) no section 864(c)(8) ECI from such hypothetical sale could be allocated to the transferor (as in the case of certain blocker structures), or (3) the transferor is not a foreign person. In our view, allowing for such exceptions is particularly important because, in our experience, very few dispositions of partnership interests will have the potential to trigger section 864(c)(8) ECI. Most interests in partnerships that are ETBUS are held either by U.S. persons or by foreign persons through U.S. blocker structures that cause the income to be taxable to U.S. corporations rather than being earned directly by the non-U.S. investors.

Such an approach would be consistent with the approach taken in Reg. §1.1445-2(b)(1). Under this regulation, the transferee of a United States real property interest is not obligated to obtain a certification of non-foreign status from the transferor and may instead rely on other means to ascertain the non-foreign status of the transferor. Of course, the transferee who relies on such other means is not protected from a liability for failure to withhold if, for whatever reason, the transferee’s determination proves incorrect and the transferor proves to be a foreign person.

25
The policy grounds for allowing an explicit exception for transfers of Never ETBUS Partnership Interests are particularly compelling. It would be unadministrable, as well as unrealistic, to expect all transferees of all partnership interests around the world to withhold or, if possible, to obtain a Specified Certification of the kind described in the Proposed Regulations. In most cases involving the transfer of a Never ETBUS Partnership Interest, none of the persons involved will be aware of Section 1446(f) and thus compliance with any applicable requirements will not be a practical possibility.

Moreover, in the extremely common case where a Never ETBUS Partnership Interest is sold at a gain and no nonrecognition provision or U.S. income tax treaty applies, the only possible Specified Certification would have to come from the partnership. Theoretically, the partnership could certify that, upon a hypothetical sale of all of the partnership’s assets for fair market value, the amount of net gain from the sale that would be ECI would be less than 10% of the total net gain from the sale. However, it should be assumed that relatively few Never ETBUS Partnerships, which generally seek to avoid U.S. tax reporting given their lack of nexus to the United States, will be willing to provide the necessary certification (regarding complex U.S. tax concepts, under penalty of perjury).

Accordingly, unless an exception applies to transfers of Never ETBUS Partnership Interests, the vast majority of transfers of partnership interests, worldwide, will result in a technical failure to withhold under the U.S. tax laws. Such a harsh result would seem inconsistent with the purposes of section 1446(f), as well as unproductive from a foreign relations perspective.

For example, suppose that France were to adopt rules similar to the Proposed Regulations. Under such rules, every U.S. transferee of an interest in a U.S. partnership with no connection whatsoever to France would theoretically be required to withhold 10% of the amount realized and to pay such amount over to France, unless certain French tax certifications (which may or may not be possible to obtain) are obtained from the transferor or the partnership. Presumably, we in the United States would consider the French rule to be overreaching and unduly extraterritorial. Undoubtedly, the reaction of other countries to our adoption of such a rule would be the same.

Therefore, while we recommend that the final regulations provide an exception for any transfer of a partnership interest if the transfer of such interest in a fully taxable disposition could not give rise to section 864(c)(8) ECI, we emphasize that the policy considerations for allowing an exception are particularly compelling where the partnership is a Never ETBUS Partnership. Of course, the burden of proof would be on the transferee (or, in the case of secondary withholding liability, the partnership).

---

26 For the sake of simplicity, we will ignore distributions by partnerships that could potentially qualify for the Partnership Books and Records Exception, although the same principles apply.

B. Secondary Withholding

As a “backstop” to ensure that transferees fulfill their withholding obligations under Section 1446(f)(1), Section 1446(f)(4) imposes a secondary withholding obligation on the partnership. Section 1446(f)(4) provides as follows:

(4) Partnership to withhold amounts not withheld by the transferee
If a transferee fails to withhold any amount required to be withheld under paragraph (1), the partnership shall be required to deduct and withhold from distributions to the transferee a tax in an amount equal to the amount the transferee failed to withhold (plus interest under this title on such amount).

Under the Proposed Regulations, a transferee may properly determine that it is not required to withhold, in reliance on a Specified Certification, or may properly determine the amount to be withheld in reliance on certain other certifications from the transferor, but may nevertheless be subject to secondary withholding on subsequent distributions from the partnership.

The Proposed Regulations provide that within 10 days after the date of a transfer of a partnership interest, the transferee (other than the partnership) must provide a certification (the “Transferee Certification”) to the partnership stating the extent to which the transferee has satisfied the transferee’s obligation to withhold under section 1446(f)(1). The Transferee Certification must either (1) include a copy of the Form 8288-A that the transferee files with respect to the transfer, or (2) state the amount realized and the amount withheld on the transfer. The Transferee Certification must also include a copy of any certifications that the transferee relied upon to apply an exception to withholding or to determine the amount withheld.

With respect to the partnership’s potential secondary withholding obligation, the Proposed Regulations provide in part as follows:

(a) Partnership’s obligation to withhold amounts not withheld by the transferee—

(1) In general. If a transferee fails to withhold any amount required to be withheld under §1.1446(f)-2, the partnership in which the interest was transferred must withhold from any distributions made to the transferee pursuant to this section. To determine its withholding obligation under this paragraph (a)(1), a partnership may rely on a certification received from the transferee described in §1.1446(f)-2(d)(2) unless it knows, or has reason to know, that the certification is incorrect or unreliable.

---

28 Prop. Reg. §1.1446(f)-2(d)(2). If the transferee is required to withhold under section 1446(f)(1), the transferee must pay over the amount withheld to the Service no later than the 20th day following the date of the transfer using Forms 8288 (U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests) and 8288-A (Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests). Prop. Reg. §1.1446(f)-2(d)(1).


30 Prop. Reg. §1.1446(f)-3(a)(1).
Under the above Proposed Regulation, it is not entirely clear whether secondary withholding would be required in a scenario where (1) the transferee properly relied on a certification from the transferor in order to not withhold (or to determine the amount withheld), such that the transferee was in complete compliance with the transferee’s obligations under Section 1446(f)(1) and Proposed Treasury Regulations Section 1.1446(f)-2, but (2) due to the partnership’s possession of information not available to the transferee, the partnership nevertheless knows that the Transferee Certification is incorrect or unreliable.

The first sentence of the Proposed Regulation suggests that secondary withholding is not required, because this sentence calls for secondary withholding only where “a transferee fails to withhold any amount required to be withheld under §1.1446(f)-2.” On the other hand, the second sentence of the Proposed Regulation provides that the partnership may not rely on the Transferor Certification if it knows or has reason to know such certification is incorrect or unreliable.

The Preamble clarifies that Treasury and the Service intended the Proposed Regulation to require secondary withholding in such circumstances.

Because the partnership may have information that may not be available to the transferee (for example, information in its books and records), a partnership may know, or have reason to know, that an underlying certification is incorrect or unreliable, even though the transferee properly relied on the certification. In this case, the partnership would be required to withhold on the transferee under section 1446(f) to the extent required in proposed §1.1446(f)-3.

The imposition of a secondary withholding obligation where the transferee acted properly in relying on a certification from the transferor and thus has fully complied with the transferee’s obligations under Section 1446(f)(1) (a “Fully Compliant Transferee”) is problematic. First, section 1446(f)(4) applies by its terms only where “a transferee fails to withhold any amount required to be withheld under §1.1446(f)-2.” This clearly is not the case for a Fully Compliant Transferee. Accordingly, we believe that imposing secondary withholding in such circumstances is contrary to the statute. Moreover, in our view, the only purpose of Section 1446(f)(4) is to ensure that transferees meet their obligations under section 1446(f)(1). Once a transferee has fulfilled such obligation, there is no justification for withholding on distributions to the transferee under section 1446(f)(4).

In this regard, it should be emphasized that amounts withheld by a partnership on distributions to a transferee would not be creditable to the transferee. Pursuant to the Proposed Regulations: “A transferee may not obtain a refund when the amount withheld under this Section exceeds the transferee’s withholding tax liability under §1.1446(f)-2. Instead, only the partnership may claim a refund on behalf of the transferee for the excess amount under this Section.”

---

31 In this regard, we emphasize that a transferee may not rely on a Specified Certification if it knows such certification to be incorrect or unreliable. Prop. Reg. §1.1446(f)-2(b)(1); see also Prop. Reg. §1.1446(f)-2(c)(1) (similarly prohibiting a transferee from relying on a certification in determining the amount required to be withheld if the transferee knows the certification to be incorrect or unreliable).

32 Prop. Reg. §1.1446(f)-3(e)(2).
The Proposed Regulations apparently contemplate that the transferee may be made whole if the partnership obtains a refund of the “excess amount” of secondary withholding, and then forwards such refund to the transferee, but there are at least two problems with this approach.

First, it is far from clear what amount, if any, the Service may consider “excess” in a given scenario. The Service may, for example, consider the secondary withholding to be excess only to the extent, if any, that the combined amount of withholding (by the transferee and the partnership), plus any tax paid by the transferor, exceeds the transferor’s tax liability for the year in which the transfer takes place. Moreover, even where such excess withholding has taken place, this will typically be difficult, if not impossible, to demonstrate, e.g., due to strict taxpayer privacy rules.

Second, the only person that would have the ability to seek a refund of the secondary withholding tax is the partnership. However, the partnership will have little or no incentive to seek such a refund on behalf of the transferee partner. Accordingly, a payment of secondary withholding tax by a partnership will in many if not most instances be a permanent exaction from the transferee.

In our view, it is neither equitable nor consistent with the language or purpose of Section 1446(f)(4) to impose a burden on a Fully Compliant Transferee by subjecting such transferee to secondary withholding. Therefore, we recommend that the final regulations eliminate any requirement that the partnership withhold under section 1446(f)(4) on distributions to Fully Compliant Transferees.

We acknowledge that eliminating secondary withholding on distributions to Fully Compliant Transferees will prevent the Service from being able to collect the tax owed by the transferor in those circumstances in which the transferee has properly relied on a certification from the transferor but the partnership knows, or has reason to know, that such certification is correct or unreliable. In our view, however, this is both appropriate and consistent with how withholding rules operate in other contexts.

For example, a transferee of a U.S. real property interest who receives and properly relies upon a certification of non-foreign status from the transferor is not required to withhold under

---

33 Under a less burdensome approach, the secondary withholding would be considered excess at least to the extent that the combined amount of withholding (by the transferee and the partnership) exceeds the transferor’s tax liability, if any, arising from the transferor’s transfer of the relevant partnership interest to the transferee (even if the transferor nevertheless owes U.S. federal income tax on account of having realized other ECI, or other U.S.-source income subject to U.S. federal income tax, during the transferor’s taxable year).

34 The partners of a partnership may potentially agree to include in the partnership’s operating agreement (or other governing document) a provision requiring the partnership to attempt to request such refunds for the benefit of their transferee partners, but it would not be realistic to expect such provisions to be commonplace.
section 1445(a).\textsuperscript{35} If it ultimately turns out that the certification is incorrect, the transferee is not liable, so the risk of an incorrect certification is placed squarely on the government.\textsuperscript{36}

The same approach applies in the case of payments subject to withholding under Section 1441 or section 1442. For example, if a payee claims to be entitled to a reduced rate of withholding tax under a U.S. income tax treaty, and the withholding agent does not have “actual knowledge or reason to know otherwise,” the withholding agent may rely on such treaty claim and is not liable if it turns out that the treaty claim is incorrect.\textsuperscript{37}

We recognize that, unlike the other provisions of the Code noted above, section 1446(f)(4) provides for secondary withholding. However, we are not aware of any reason to believe that Section 1446(f)(4) was intended to subject transferees of partnership interests to strict liability or was otherwise intended to depart from the fundamental withholding rules that apply in other contexts. In our view, it is reasonable and appropriate to limit the application of section 1446(f)(4) to negligent transferees who have not fulfilled their obligations under section 1446(f)(1). Indeed, by its own terms, section 1446(f)(4) applies only if the transferee “fails to withhold any amount required to be withheld” under Section 1446(f)(1).

We also wish to address a second issue with respect to secondary withholding under the Proposed Regulations. Even if the partnership has no reason to believe the Transferee Certification is incorrect or unreliable, the Proposed Regulations merely provide that the partnership “may” rely on such certification.\textsuperscript{38} That is, it appears that the partnership may instead choose to disregard the Transferee Certification and thus withhold on distributions to the transferee under Section 1446(f)(4) if, for whatever reason, it wishes to do so.

The authority to withhold on distributions is a powerful weapon, and the Proposed Regulations would give the partnership a substantial power that easily may be abused. For example, a partnership may well use the threat of secondary withholding to extract substantial concessions from a transferee. Alternatively, a partnership may simply adopt a policy of imposing secondary withholding as a matter of course, as this would save the cost of paying a qualified tax professional to review Transferee Certifications.

Unless steps are taken to protect transferees of partnership interests from such unnecessary secondary withholding, well-informed transferees are likely to conclude that the only way to protect themselves from a burdensome secondary withholding cost that likely will never be

\begin{footnotesize}
\textsuperscript{35} Reg. §1.1445-2(b)(2). The transferee may not rely on a certification if (i) such certification is based on an election under section 897(l) and a copy of the election is not attached to the certification; (ii) the transferee knows such certification to be incorrect; or (iii) the transferee receives a notice from a transferor’s or transferee’s agent under Reg. §1.1445-4 to the effect that such certification is false. See Reg. §1.1445-2(b)(4).

\textsuperscript{36} Reg. §1.1445-2(b)(1) (“Except to the extent provided in paragraph (b)(4) of this section, the obtaining of this certification excuses the transferee from any liability otherwise imposed by section 1445 and §1.1445-1(e).”).

\textsuperscript{37} Reg. §1.1441-6(b)(1). Under this regulation, the payee provides to the withholding agent a “beneficial owner withholding certificate” that provides certain information and representations.

\textsuperscript{38} Prop. Reg. §1.1446(f)-3(a)(1).
\end{footnotesize}
recovered is to withhold the maximum possible amount under section 1446(f)(1) on all transfers. In each such case, the transferor would be forced to claim a credit for the amount withheld and to seek a refund. This approach would be burdensome not only for transferors but for the Service as well.

Accordingly, we recommend that, in the case of a Fully Compliant Transferee, the partnership should be neither required nor permitted to withhold under section 1446(f)(4).