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Re: Recommendations on implementation of section 1446(f)

Dear Gentlemen:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to submit comments on Notices 2018-08[2] and 2018-29[3] (the "Notices") regarding the withholding

[1] SIFMA is the voice of the US securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the US, serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the US regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.
[2] Notice 2018-08, 2018-7 IRB 352.
[3] Notice 2018-29, 2018-16 IRB 495.

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under new section 1446(f) of the Internal Revenue Code[4] on dispositions of certain partnership interests by foreign persons. Both Notices requested comments on the challenges that apply to transfers of publicly traded partnerships ("PTPs") under section 1446(f). Notice 2018-29 provides proposed rules for withholding on dispositions of non-PTP interests, but it does not apply to PTPs and it is not clear whether the Treasury Department (Treasury) and Internal Revenue Service ("IRS") intend, by regulation, to extend the rules in the notice to dispositions of interests in PTPs. While there are some common challenges to implementing the withholding requirements on sales of PTP interests and non-publicly traded partnership interests, there is a need for different rules for withholding on PTPs because of the relationships of the parties, the lack of information to make withholding determinations, and the frequency of dispositions. Accordingly, this letter seeks to highlight the differences when the transfer is with respect to a PTP and make recommendations for rules that are operationally feasible. This letter also provides recommendations on the guidance for non-PTPs based on Notice 2018-29.

Section I of this letter provides background on sections 864(c)(8) and 1446(f). Section II discusses the current withholding requirements on PTP distributions. Section III provides recommendations for addressing the operational challenges of withholding on PTP dispositions. Section IV requests certainty on the lending or holding as collateral a PTP interest. Lastly, Section V of this letter makes recommendations on the certification-based withholding exceptions provided in Notice 2018-29, divided into recommendations related to PTPs, recommendations related to non-PTPs, and recommendations related to both PTPs and non-PTPs. SIFMA is seeking to provide the Treasury and the IRS with recommendations, in response to the Notice, that are administrable for taxpayers and the IRS alike.

I. Background

The Tax Cuts and Jobs Act (P.L. 115-97) added two new provisions to the Code concerning sales of partnership interests by foreign persons. Section 864(c)(8) treats a foreign partner's gain (or loss) from the disposition of an interest in a partnership as effectively connected income subject to US net income tax to the extent that the partner would have had effectively connected gain (or loss) had the partnership sold all of its assets at fair market value on the disposition date. Section 1446(f) requires that a transferee of a partnership interest from a foreign person withhold 10 percent of the "amount realized" by the outgoing partner "if any portion of the gain (if any) on any disposition of an interest in a partnership would be" subject to tax under section 864(c)(8). If the transferee fails to withhold the correct amount of tax under section 1446(f), the partnership has the obligation to withhold from future distributions to the transferee partner. Section 1446(f) applies to dispositions of partnership interests after December 31, 2017. Because the tax resulting from section 864(c)(8) is a net income tax and the withholding under section 1446(f) is on gross basis, one can anticipate that both overwithholding and underwithholding will be common.

Notice 2018-08 requests comments on the guidance that may be needed to assist taxpayers in applying new sections 864(c)(8) and 1446(f). On February 13, 2018, SIFMA submitted a letter listing

[4] Except as otherwise expressly provided herein, all references to a "section" are to sections of the Internal Revenue Code of 1986, as amended (the "Code"), and all references to "Treas. Reg. §" or "Regulations" are to Treasury Regulations issued pursuant to the Code. Furthermore, all references to the "IRS" or the "Service" are to the Internal Revenue Service.

the numerous questions regarding the withholding requirements for dispositions of interests in non-PTPs and requested a permanent suspension of withholding for dispositions of interests in PTPs. Notice 2018-29 provides guidance for withholding on dispositions of interests in non-PTPs and provides several significant exceptions to withholding. Notice 2018-29 also suspends the requirement that partnerships withhold on future distributions to new partners if those partners failed to withhold on the amount realized by the selling partners.

II. Current state of withholding on PTP distributions

1. PTP interests held by Nominees

As will be discussed below, the nature of the PTP market makes it virtually impossible for a buyer (i.e. the "transferee") of a PTP interest to identify the seller (i.e. the "transferor"), and it is likely undesirable from a tax administration standpoint to impose a withholding obligation on the numerous buyers of PTP interests.

Interests in PTPs trade as limited partnership units on the New York Stock Exchange, the Nasdaq market and other markets in a manner similar to stocks. Such interests generally are held in "street name" through the book-entry facilities of a central securities depository ("CSD") and its participating banks and brokers. Investors can only hold such interests through an account with a CSD participant (or other entity that clears through such a participant). The participant in turn holds all of the interests on behalf of its customers in a single "omnibus" account at the CSD. Trades are cleared on a bulk basis through the CSD.

Also, prospective purchasers and their brokers do not need to find a willing seller, and vice versa. Purchase orders and sale orders on these markets go through an entity that acts as a market maker in such interests.[5]

As a result, it is not possible as a practical matter for a buyer of a security to identify the seller of the particular securities purchased. This is as true for PTP interests as it is for other types of publicly traded securities. Moreover, no PTP or transfer agent nor the CSD has any reasonable means of knowing who owns the securities at any given moment. The PTP and any transfer agent can only "see," and cannot look through, the CSD (or its nominee). The CSD can only "see," and cannot look through, its participating banks and brokers.

A system has evolved under the rules of Treas. Reg. § 1.6031(c)-1T for a third party to extract information from custodians regarding who owns interests in any PTP, typically on a monthly basis. The third party compiles and provides the information to the PTPs, which subsequently issue Schedules K-1 to the partners.[6] This information is not, and cannot be, made available to PTPs on a real time basis. The custodian typically would not have access to the Schedules K-1 or track any PTPs income or losses.

[5] A "specialist," on the New York Stock Exchange.

[6] This is a cumbersome process that has not proven, in practice, to be entirely free from errors. We would not recommend duplicating it for purposes of Section 1446(f).

2. Withholding on Distributions by PTPs

Under sections 1446(a) and (b) of the Code, distributions of effectively connected taxable income ("ECTI") by a partnership are subject to a withholding tax of 21% if the partner is a foreign corporation and 37% if the partner is a foreign individual or non-corporate entity. Withholding on ECTI for PTPs, unlike withholding with respect to non-PTPs, is linked to distributions by the partnership, not the partnership's receipt of taxable income. Because PTP interests are generally held in street name, the PTPs do not know the US or foreign status of their partners, at least at the time of the distribution. Special rules in Treas. Reg. § 1.1446-4 applicable to PTPs make a "nominee" (typically a custodian) who holds a PTP interest on behalf of a foreign person the withholding agent, but only to the extent the PTP publishes a "qualified notice"[7] stating the extent to which a distribution should be treated as ECTI. The nominee is responsible for establishing the US or foreign status of the holder of the interest, and for withholding and depositing the tax. The payments and tax withholding are reported to the IRS on Forms 1042 and 1042-S,[8] in contrast to ECTI distributions from non-PTPs, which are reported on Forms 8804 and 8805.[9] The use of Forms 1042 and 1042-S allows custodians to leverage their systems and procedures that apply to other payments to foreign persons, rather than creating entirely new systems and procedures.

The work involved in withholding on PTP distributions can generally fit into a custodian's general monitoring of corporate actions. Withholding is based on distributions, distributions are usually periodic and no more frequently than monthly, and PTPs typically publish qualified notices indicating the portion of a distribution that is ECTI or otherwise provide disclosures instructing the nominee to treat the entire distribution as ECTI.

3. Lack of Basis Information

Since 2011, brokers have been required to track and adjust customers' basis in "covered securities" under sections 6045(g) and (h), 6045A and 6045B of the Code and the associated Regulations. Partnership interests are not among the categories of securities subject to the cost basis rules, and for good reason. A partner's basis in a partnership interest increases when the partnership has income and is subject to the other adjustments mandated by Subchapter K. Custodians typically do not have access to the necessary information, especially since the Schedules K-1 go directly from the PTPs to investors. Custodians also do not have the appropriate expertise to make these adjustments. In addition, brokers are generally excused from tracking basis on securities held by foreign persons.[10] Accordingly, brokers are not in a position to determine a foreign PTP holder's gain or loss. In addition, brokers generally have no information about the state of a PTP's liabilities or whether a PTP unit holder would be considered responsible for those liabilities.[11]

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[7] "Qualified notices" are a concept of securities law, not tax law. 17 CFR §240.10b-17(b)(1).

[8] See Treas. Reg. § 1.1446-4(c).

[9] See Treas. Reg. § 1.1446-3(d)(1)(iii).

[10] See Treas. Reg. § 1.6045-1(a)(15)(iv)(C).

[11] Under the so-called "anti-*Raphan*" rules of Treas. Reg. §§1.752-1 *et seq.*, a partner's share of the liabilities of a partnership depends in part upon whether the partner extended the loan and whether the partner is personally liable on the loan.

To date, no provision of US law that has been implemented requires a broker to withhold tax on foreign persons who receive the gross proceeds of a sale of publicly traded securities.[12] The FIRPTA rules of section 1445 require withholding at a flat rate on proceeds of sale of securities in US entities that predominantly own US real estate, but section 1445(b)(6) wisely provided that withholding does not apply to sales of shares of stock that are regularly traded on an established securities market.

III. Recommendations to address operational challenges

As stated in SIFMA's previous letter, due to the significant operational challenges, SIFMA believes that the Treasury should use its regulatory authority under Section 1446(f)(6) to exclude dispositions of PTP interests from withholding. Further, as we read the statute, only "the transferee shall be required to deduct and withhold" the required tax. While the IRS and Treasury have authority in section 1446(f)(6) to make exceptions to withholding and other "necessary" regulations, and the authority under preexisting subsection (g)(1) to make rules for PTPs, it is not clear that the IRS and Treasury have authority to impose a duty to withhold, and therefore a potential tax liability, on anyone other than the transferee. Given that it is not possible for a transferee of publicly traded securities to identify the transferor or withhold tax, our members believe it would be appropriate for the regulations to make a complete exception for sales of PTP interests under the authority granted in subsection (f)(6). Such an exception would eliminate the need to consider the myriad issues we describe in this letter.

If the IRS and Treasury believe that the statute can be read to include regulatory authority to impose withholding tax liability on someone not identified in the statute as potentially liable, any such extension of the withholding obligation in the PTP space should emphasize operational administrability, and should not attempt to replicate every exception and nuance of the non-PTP rules. In order for withholding on dispositions of PTPs to be operationally administrable, SIFMA requests that the rules provide the following:

(1) The transferor/seller's broker is the withholding agent
(2) Withholding applies only to the extent of the cash proceeds paid to the seller/transferor
(3) The transferee/buyer and the partnership are relieved of any liability for withholding as the buyer or partnership will not be able to determine whether the transferor's broker withheld to the extent required
(4) The transferor's broker is not responsible for withholding on distributions that exceed basis
(5) Withholding and reporting rules leverage existing regulations for PTPs for forms, deposit mechanisms, etc.

1. The transferor's broker should be the withholding agent

The Conference Report for the Tax Cuts and Job Act, which enacted section 1446(f), anticipates the difficulties of imposing a withholding obligation on the transferee for dispositions of PTP interests:

[12] FATCA nominally requires gross proceeds withholding on nonparticipating FFIs, but the requirement has not been implemented to date. See Treas. Reg. § 1.1473-1(a).

> Additionally, the conferees intend that, under regulatory authority provided by the Senate amendment to carry out withholding requirements of the provision, the Secretary may provide guidance permitting a broker, as agent of the transferee, to deduct and withhold the tax equal to 10 percent of the amount realized on the disposition of a partnership interest to which the provision applies. For example, such guidance may provide that if an interest in a publicly traded partnership is sold by a foreign partner through a broker, the broker may deduct and withhold the 10-percent tax on behalf of the transferee.[13]

While the Conference Report contemplates withholding by a broker on dispositions of PTPs, it leaves to Treasury and the IRS broad authority to determine how that withholding should occur.

The transferor's broker (within the meaning of Treas. Reg. § 1.6045-1(a)) is in the best position to facilitate the withholding on a disposition of a PTP interest. First, brokers currently obtain documentation from customers to determine their US or foreign status for purposes of any distributions paid by the PTP. Second, the transferor's broker (who is typically also the "nominee" under the ECTI regulations) already withholds on PTP distributions. The transferee and its broker, by contrast, have no information about the transferor due to the way the public markets work. The market would have to be fundamentally restructured to enable the transferee or its broker to obtain the information to withhold correctly.

Only the broker directly facing the transferor should be required to withhold. It is common for multiple brokers to be involved in a sale of securities, so the rules for gross proceeds reporting (and, consequently, backup withholding) contain a "multiple broker" rule[14] and a "cash on delivery" rule[15] that have the effect that only the broker with a direct account relationship with the seller (*i.e.*, "facing" the transferor directly) and acting as broker for the seller is required to perform withholding. The reason is that only the broker facing the seller would have both the account documentation and access to the gross proceeds. The same practical considerations are present in the disposition of a PTP interest.

2. Withholding should apply only to the extent of 10% of the cash proceeds paid to the seller/transferor

Notice 2018-29 provides that if any portion of the gain on any disposition of an interest in a partnership would be treated as effectively connected income, then withholding is required on the amount realized on the disposition. Further section 8 of Notice 2018-29 provides that the amount of withholding is generally limited to the total amount of cash and property to be transferred, but in order to withhold less than the entire amount of cash consideration, it is necessary to determine the portion of the partnership's liabilities for which the partner is responsible.

[13] Conference Report on H.R. 1, Tax Cuts and Jobs Act, H. Rept. 115-446 at 369. The language is not clear regarding whether it is the buyer's or the seller's broker who should be required to withhold. The first sentence suggests that the buyer's broker would withhold; the second sentence suggests that the seller's broker is somehow an agent for the buyer and should withhold. We do not think the IRS is required to, or should, take the Conference Report literally or try to reconcile the possible meanings of the paragraph. The Conference Report is best viewed as the conference committee's recommendation that the IRS and Treasury do something to take account of the distinct nature of the PTP market.

[14] See Treas. Reg. §1.6045-1(c)(3)(iii).

[15] See Treas. Reg. §1.6045-1(c)(3)(iv)

SIFMA appreciates efforts of Treasury and the IRS to draft a set of certifications and backup rules to estimate the partner's substantive tax liability. However, no set of rules is likely to result in withholding of the correct amount of tax in more than a small number of dispositions because section 864(c)(8) treats as ECI only the partner's share of the partnership's gain or loss that would have been ECI if the partnership had sold all of its assets for their fair market value as of the date of the disposition. Further, because a partner increases its outside tax basis in a partnership when its share of partnership liabilities increases, a reduction of those liabilities (including by reason of a sale of the interest, under section 752(d)) generally operates to offset the increase in basis the partner previously was entitled to - but does not represent "gain" to the seller that withholding should be based on. Thus, basing the withholding amount on the liability decrease generally overstates the necessary amount of withholding.

Since a set of rules cannot be fashioned to ensure that the withholding tax liability equals the partner's substantive tax liability under section 864(c)(8), SIFMA stresses the need for operationally administrable rules, the most important being to limit withholding to 10% of the cash proceeds regardless of the transferor's basis or share of partnership liabilities.

Absent readily available information regarding the partner's basis, the partnership's liabilities and the nature of those liabilities (recourse or non-recourse), it is also operationally impossible for a custodian to determine the amount realized on a PTP interest in the manner described in Notice 2018-29. Section I of this letter describes the lack of information between the transferor and transferee in a disposition of a PTP interest and, from an operational perspective, the transferor's custodian only has knowledge of a sale and the cash proceeds of the sale. Further, because dispositions will occur frequently, withholding agents will not be able to develop a timely process to respond to any certifications regarding the transferor partner's share of partnership liabilities as described in section 7.02 or section 7.03 of Notice 2018-29 or information regarding the transferor's basis in its PTP interest. Therefore, SIFMA requests that withholding apply to 10% of the total amount of cash paid or credited to the selling foreign partner without regard to whether such proceeds are equal to the amount realized.

3. The transferee in a PTP disposition should have no residual withholding obligation

Given the recommendation above to make the transferor's custodian the withholding agent, SIFMA also requests that the transferee be relieved of any residual withholding responsibility as the transferee will not know, and has no way to determine, whether tax has been withheld. The transferee will make a payment in gross to its own broker/custodian, which will eventually be paid to the transferor through the market's settlement system, and therefore the transferee will not know, or have reason to know, that the transferor's custodian may not have satisfied the withholding tax liability (or even whether the transferor is foreign).

4. The transferor's broker should not be responsible for withholding on distributions that exceed basis

Notice 2018-29 states that distributions in excess of a partner's outside basis are considered "dispositions" for the purposes of section 1446. However, it is almost impossible for a broker to know a partner's adjusted basis in its PTP interest, as discussed above. It necessarily follows that brokers should be able to disregard the possibility of a distribution in excess of basis on a PTP.

Substantive liability of the partner would, of course, be a separate matter from the triggering of a withholding tax.

5. Leverage existing regulations for withholding and reporting on dispositions of PTP interests

SIFMA requests that the regulations under section 1441 be leveraged to the extent that brokers of sales of PTP interests are required to withhold and report. In particular, information returns should be on Form 1042-S and the liability for withholding under section 1446(f) should be included with the other withholding liabilities reported on Form 1042 (the "Form 1042/1042-S model").

a. General rules for withholding, reporting and depositing should be similar to chapter 3 and Treas. Reg. § 1.1446-4

As Treasury and the IRS recognized in the implementation of the section 1446(a) regime, PTPs and non-PTPs are different in fundamental ways and should be subject to different rules. The general rules for reporting and making payments of taxes withheld under section 1446 do not apply to PTPs. Section 1.1446-4(d) requires a nominee to deposit tax in accordance with Treas. Reg. § 1.6302-2, the same schedule for taxes withheld under sections 1441, 1442, 1471, and 1472. The regulations under section 1446 also conform to the information reporting requirements of the regulations under sections 1441, 1442, 1471, and 1472 by requiring a nominee to report withheld amounts on Forms 1042 and 1042-S.

Notice 2018-29, on the other hand, requires the reporting of tax withheld on dispositions of non-PTPs to be reported on Form 8288, US Withholding Tax Return for Dispositions by Foreign Persons of US Real Property Interests, and Form 8288-A, Statement of Withholding on Dispositions by Foreign Persons of US Real Property Interests. These forms were originally developed under the FIRPTA rules of Section 1445, where withholding is not required on publicly-traded interests. The Form 8288/8288-A system was not designed for public market transactions.[16]

The interests of efficient tax administration would be ill-served by the creation of a new set of parallel tax returns, information returns and deposit schedules for section 1446(f) withholding on dispositions of PTP interests. Income codes on Form 1042-S should provide the IRS sufficient information to enforce the PTP withholding requirement. SIFMA requests that the Form 1042/1042-S model for distributions of PTPs be extended to dispositions of interest in PTPs. It should also be made clear, through the definition of amounts subject to reporting, that a PTP disposition is reportable only when withholding actually occurs (similar to foreign branch deposit interest under FATCA). The adoption of the Form 1042/1042-S model will enable withholding agents, as they have for PTP distributions, to leverage existing withholding and reporting processes. In addition, deposits would be made on the same quarter-monthly schedule as other Form 1042 liabilities, which will generally result in faster deposits than the 20-day schedule contemplated by Notice 2018-29.

[16] We express no view on whether withholding on sales of non-PTPs under Section 1446(f) should be reported on modified Forms 8288/8288-A or an entirely new set of forms.

b. Qualified intermediaries and withholding foreign partnerships and trusts

The regulations under Treas. Reg. § 1.1446-4(d) provide the requirements for withholding by nominees on distributions by PTPs. The regulations define a nominee as a domestic person, thus limiting the ability for qualified intermediaries and withholding foreign partnerships and trusts that assume withholding responsibility under section 1441, 1442, 1443, 1471, and 1472 to assume withholding responsibility under section 1446. Consequently, custodians must depart from their standard withholding operation when withholding on PTP distributions. Further, most custodians are unable to maintain dual tax statuses for a single relationship, resulting in custodians overwithholding on foreign sub-custodians that would otherwise assume withholding responsibility. In order to align withholding under section 1446 with other withholding processes, SIFMA requests that the qualified intermediary agreement and withholding foreign partnership and trust agreements apply to section 1446.[17]

c. Documentation and withholding for PTP interests held by nonqualified intermediaries, nonwithholding qualified intermediaries, and nonwithholding foreign partnerships/trusts

Withholding on sale proceeds through a non-US intermediary is challenging as withholding statements only include information on U.S. source fixed, determinable, annual, or periodic (FDAP) income and do not allocate proceeds for a given sale to an identified transferor.[18] As stated above, interests in PTPs trade in a manner similar to stocks and are held by non-U.S. persons through non-U.S. intermediaries.[19] U.S. custodians executing transactions on behalf of clients of non-U.S. intermediaries do not have systems that can segregate who disposes of a given security. Given the shortness of the settlement period (T+2), there is insufficient time to determine whether the transferor is U.S. or non-U.S. after trade date.[20] Accordingly, SIFMA requests that a U.S. withholding agent be required to treat a payment through a nonqualified intermediary or qualified intermediary that does not assume primary withholding responsibility as made to a non-U.S. person and, consistent with our request above, withhold on 10 percent of the cash proceeds. To the extent that our above recommendation to apply the qualified intermediary agreement to section 1446 is adopted, the required 10 percent withholding on cash proceeds paid to a qualified intermediary that does not assume primary withholding responsibility would be refundable by the qualified intermediary, subject to the collective refund procedures, to the extent that the qualified intermediary establishes that the persons on whose behalf it is acting is eligible for a refund, based upon one or more of the certification-based exceptions having been satisfied.

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[17] The IRS also should consider allowing QIs to withhold under section 1445 on "look-through" distributions by qualified investment entities under section 897(h)(1).

[18] Treas. Reg. § 1.1441-1(e)(3)(vi).

[19] Treas. Reg. § 1.1446-1(c)(2) is not as clear on the documentation requirements of the beneficial owners of the income that hold their interest in the PTP through a non-US intermediary. The regulations state that in in case of a nominee, the "the beneficial owner of the partnership interest, not the nominee, shall submit a Form W-8," which strongly implies that the nominee should provide a Form W-8IMY so that the partnership can associate the payments with the beneficial owner.

[20] Treasury and IRS, likely recognizing these challenges, limited Form 1099 reporting and backup withholding on gross proceeds paid to an account holder of a non-U.S. intermediary. See Treas. Reg. §§ 1.6049-5(d)(3)(ii), 31.3406(b)(3)-2(b), and 31.3406(g)-1(e).

With respect to a nonwithholding foreign partnership or trust, it could be assumed that each partner will be allocated a portion of the sales proceeds. Under this assumption, it would be operationally administrable to further assume, for section 1446(f) purposes only, that the income allocations provided for U.S. source FDAP income are representative of the allocation of sales proceeds. SIFMA would be in support of an allowance, for section 1446(f) purposes only, for U.S. withholding agents to treat income allocations as an allocation for sales proceeds and withhold accordingly.

d. Presumption rules for section 1446(f) should coordinate with existing chapter 3 and chapter 61 rules

The "presumption rules" under chapters 3 and 61 instruct a withholding agent, broker or payor on what to do when it lacks documentation sufficient to categorize the beneficial owner, customer or payee under U.S. tax rules. The presumption rules generally impose the highest plausible rate of withholding in a given situation. With respect to securities sales through accounts in the U.S., individuals and entities lacking indicia of foreign status are generally presumed to be U.S. persons subject to 24 percent backup withholding on gross proceeds. On the other hand, "exempt recipients" and entities with indicia of foreign status (such as a foreign mailing address) generally are not subject to backup withholding on sales of securities.

The definition of "securities" for Form 1099-B purposes includes partnership interests,[21] which means that sales of partnership interests by brokers are subject to backup withholding. On the other hand, redemptions of partnership interests by the partnership are generally not subject to Form 1099-B reporting,[22] and thus are not subject to backup withholding.

Section 6.01 of Notice 2018-29 states that a transferor is presumed foreign unless the transferee receives a Form W-9 or other certification of non-foreign status. This would actually result in a lower rate of withholding (10 percent) than brokers would otherwise be obligated to impose on undocumented U.S. non-exempt recipients selling PTP interests (24 percent). In addition, if the regulations do not adopt our suggestion to limit withholding on PTPs to cash proceeds, and require that the amount realized on a PTP interest include partnership liabilities, the amount subject to withholding under section 1446(f) could be greater than the gross proceeds, and that would create an extremely difficult operational problem for brokers attempting to take a conservative position by doing greatest amount of withholding. Either 10 percent of the amount realized or 24 percent of the gross proceeds could be the bigger number. Systems currently in existence do not have the ability to run both calculations and withhold the greater amount.

SIFMA recommends that if, after the application of the existing presumption rules, the transferor of a partnership interest (whether or not a PTP interest) is presumed to be a U.S. non-exempt recipient and the sale is reportable on Form 1099-B, backup withholding at 24 percent of the gross proceeds should apply and withholding and reporting under section 1446(f) should not apply. This should be the rule even if IRS and Treasury decline our request that section 1446(f) withholding be limited to cash paid or credited to the transferor. If backup withholding would not apply to the sale (i.e., the customer would be presumed a foreign person or a U.S. exempt recipient, or the sale or redemption

[21] See Treas. Reg. § 1.6045-1(a)(3)(iii).
[22] See Treas. Reg. § 1.6045-1(c)(3)(v).

is excepted from Form 1099-B reporting), the section 1446(f) presumption of foreign status would control.

IV. Securities Lending and Collateral

SIFMA notes that publicly traded securities, including PTP interests, are included in standard commercial securities lending practices and collateral arrangements. It is not settled whether a common law concerning securities lending transactions, which might apply to PTP interests, survived the enactment of section 1058 with the result that no disposition, or a non-recognition disposition, occurs in a loan of a PTP interest. The IRS and Treasury need not resolve this uncertainty in the section 1446(f) regulations; rather, the regulations should exclude a loan of a PTP interest or the posting of a PTP interest as collateral (as well as the return of the loaned or collateral PTP interest) from the definition of a "disposition" under the authority to make exceptions to withholding under section 1446(f)(6), provided the transaction substantially conforms to section 1058. Such an exception would preserve the withholding obligation when the PTP interest is eventually sold. Failure to make an exception will create a substantial disruption of the securities lending and collateral market.

V. Recommendations related to certification-based exceptions in Notice 2018-29

Notice 2018-29 includes numerous certification-based exceptions to withholding:

- Use of a Form W-9 in lieu of an affidavit of non-foreign status.
- A certification by the transferor that its allocable share of ECTI was less than 25% of the transferor's distributive share of income in each of the three preceding years (which certification cannot be made more than 30 days prior to the disposition) ("*de minimis* ECTI")
- A certification by the partnership that less than 25% of the gain from a sale of its assets would be ECI ("*de minimis* ECI gain")
- A certification by the transferor that it will not realize gain on the disposition
- A certification by the transferor that the disposition is a transaction in which gain and loss is not immediately recognized
- A certification by the transferor or the partnership regarding the transferor's share of partnership liabilities.

SIFMA has divided the following recommendations with respect to those certifications into those relevant to both PTPs and non-PTPs, those pertinent to PTP transactions, and those directed to non-PTP transactions.

1. Recommendations for certifications that would apply to both PTPs and non-PTPs

a. *De minimis* ECTI and *de minimis* ECI gain thresholds

Notice 2018-29 stated that the 25 percent thresholds for *de minimis* ECTI and *de minimis* ECI gain may be reduced by subsequent guidance, but SIFMA believes that lowering that thresholds will substantially diminish the ability and willingness of partnerships and transferors to certify. SIFMA requests the thresholds remain at 25 percent. If the *de minimis* thresholds are reduced below 25 percent, the potential for significant overwithholding exists. The 25 percent thresholds effectively provide a margin of safety that gives partnerships and transferors confidence that they can provide the certification. A lower threshold would introduce risk that partnerships and transferors will not be comfortable providing the *de minimis* certification, thereby resulting in unnecessary overwithholding that will burden both taxpayers and the IRS with avoidable refund claims.

b. Historically compliant taxpayer

As discussed above, withholding under section 1446(f) will likely produce overwithholding necessitating the transferor to file a claim for refund or credit. Therefore, SIFMA supports a withholding exception for "identifiable historically compliant taxpayers" as suggested in Notice 2018-29. This exception could be implemented through a certification from the transferor that includes the transferor's U.S. taxpayer identification number and states that the transferor has filed, and will continue to file, U.S. income tax returns that report any ECI related to the investment(s) that are the subject of the certification. A broker, partnership or transferee should be able to rely upon such certification indefinitely unless notified otherwise.

c. Retention of Form W-9

Notice 2018-29 allows Forms W-9 to be relied upon to establish the non-foreign status of a transferor. SIFMA recommends that use of Forms W-9 continue to be allowed for this purpose. However, Notice 2018-29 states that Forms W-9 can be relied upon "[u]ntil regulations … are issued." This could be read to suggest that use of Forms W-9 for this purpose is a temporary accommodation. SIFMA recommends that the regulations clearly establish that either Form W-9 or a certification described in Treas. Reg. § 1.1445-2(b) (with conforming changes for section 1446(f)) will establish non-foreign status, both for PTP and non-PTP transactions. The IRS should also confirm in regulations that a broker, partnership or transferee may rely on a Form W-9 that it has previously received, absent actual knowledge or reason to know of a change in circumstance. Requiring a separate Form W-9 for each transaction offers no advantage and may unnecessarily delay transactions.

2. Recommendations for PTP certifications

The certifications in Notice 2018-29 (other than the Form W-9) are considerably less workable for PTP interests than for non-PTP interests. In creating these certifications, the IRS seems to have had in mind a number of conditions that are not normally present in the PTP market:

1. *That the transferee has the ability to identify the transferor and request a transferor certification.* As we have indicated above, the public markets operate in such a way that, as a general matter, the buyer (or the buyer's custodian) does not know the identity of the seller.
2. *That the transferee can withhold funds if the transferor fails to make a certification.* In a public markets transaction, the buyer's broker is required to deliver all of the cash proceeds to the seller's broker at settlement or the trade will "fail," i.e., not occur.
3. *That there is sufficient time between the agreement to sell and the closing of the transaction for the transferee or partnership to do the appropriate research to certify.* Trades occur in microseconds and are settled in two days under current market rules. That is not enough time to obtain and validate certifications on a transaction-by-transaction basis.

The characteristics of the PTP market require that any exceptions to withholding be based on data or certifications that are static or updated rarely. Further, certifications by the partnership or the transferor with respect to particular PTP transactions should be exceptional.

a. *De minimis* interest holder

SIFMA supports an exception from withholding for partners that hold only a minor interest in the PTP, specifically a 5 percent or less interest. Many of the members of SIFMA currently obtain similar certifications from foreign interest holders of real estate investment trusts ("REITs") consistent with the exception to withholding for *de minimis* interest holders in REITs and other qualified investment entities. SIFMA supports an exception through a certification that the partner holds and will continue to hold, unless and until it notifies the broker otherwise, no more than 5 percent of any PTP. The broker should be able to rely upon such a certification unless inconsistent with the custodian's records. Such certifications should be valid indefinitely until revoked or revised or the broker acquires actual knowledge the certification is false.

b. *De minimis* ECTI and *de minimis* ECI gain

In order to make the *de minimis* determinations of ECTI and ECI gain for PTPs, SIFMA requests that PTPs, instead of the transferor, make the certification, and do so by publishing in a qualified notice, provided pursuant to Treas. Reg. § 1.1446-4, the percentage of their income that is ECI or the percentage of their assets that are held to produce ECI, and that brokers be permitted to rely on such determinations for dispositions made on or after the date of publication of the qualified notice until the publication of the next qualified notice.[23]

3. Recommendations for non-PTP certifications

SIFMA's members also engage in businesses that organize, administer or manage non-PTPs. We therefore request that IRS and Treasury take the following into account in crafting rules for disposition of interests in non-PTPs.

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[23] Although the "qualified notice" procedure for withholding on distributions by PTPs is not without flaws, we believe it could serve as a model for such a certification system. In determining how timely the periodic determinations and certifications need to be, it should be noted that some PTPs require substantial amounts of time before they can complete their tax return for a taxable year.

a. Transferor certification of its share of partnership liabilities

Notice 2018-29 provides that a transferee may determine the partnership liabilities included in the amount realized if it receives a certification from the transferor that is not a controlling partner providing the amount of the transferor partner's share of the partnership liabilities as reported on the most recent Schedule K-1 for a partnership tax year that closed no more than 10 months before the transfer. Because of the extended due date for furnishing the Schedule K-1 (September 15th for calendar year partnerships), the window to provide this certification (ending October 31 for calendar year partnerships) is too short. Accordingly, SIFMA requests that the period be extended by one year to allow reliance on the most recent Schedule K-1 for a partnership tax year that closed no more than 22 months before the transfer.

b. The amount realized on a distribution in excess of basis should include only the portion considered gain

Section 1446(f) applies to "the amount realized on the disposition." Notice 2018-29 clarifies that a distribution in excess of the partner's outside basis in the partnership interest is treated as a disposition subject to withholding, but does not specify the amount subject to withholding. For example, a partner with an outside basis of $50 million may receive a distribution of $51 million. The first $50 million should not result in any tax consequences; the remaining $1 million is gain under section 731(a) that may be taxable under section 864(c)(8). The IRS should clarify that the 10% withholding under section 1446(f) would only apply to the $1 million in excess of basis.

c. *De minimis* ECTI

1. The testing period should not require three years of ownership

In order to provide a *de minimis* ECTI certification, Notice 2018-29 requires the transferor to have been a partner in the partnership for the taxable year immediately prior to the year of the disposition, as well as the preceding two full taxable years. This rule does not appear to consider new partners and new partnerships. SIFMA request a modification of the testing period to be the shortest of (i) the life of partnership (ii) the partner's holding period, or (iii) the testing period in Notice 2018-29.

2. Funds of funds making distributions should be able to rely on *de minimis* ECTI

Notice 2018-29 does not permit a distributing partnership to rely on a *de minimis* ECTI certification (or, apparently, its own records) when the distribution results in a disposition (*i.e.,* when the distribution exceeds the partner's outside basis). The implicit assumption is that the distributing partnership is able to calculate the gain on a hypothetical disposition of all of the partnership's assets and therefore the *de minimis* rule based on income is not needed. This assumption does not hold, however, for a partnership that invests in other partnerships, often referred to as a "fund of funds." A fund of funds usually invests in partnerships that are not under common management or administration with the fund of funds, so it rarely will have the ability to do the hypothetical gain calculation immediately prior to the distribution. In such a circumstance, it should be able to use the *de minimis* ECTI certification (and, moreover, should be able to rely on its own records rather than obtain a certification from the partner).

VI. Conclusion

SIFMA appreciates your consideration of these comments, and we would welcome the opportunity to discuss the recommendations in our submission with you and your colleagues. Please do not hesitate to contact me at (202) 962-7300 or ppeabody@sifma.org, or our outside consultants Tara Ferris or Jonathan Jackel at Ernst & Young. Tara can be reached at (201) 551 5014 or tara.ferris@ey.com and Jonathan can be reached at jonathan.jackel@ey.com (202) 327-5725.

Sincerely,

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