Invested in America

July 15, 2019

Mr. Chip Harter
Deputy Assistant Secretary (International Tax Affairs)
Department of the Treasury
1400 Pennsylvania Avenue, NW
Washington, DC 20224

Ms. Kamela Nelan
Attorney-Advisor (Office of Tax Policy)
Department of the Treasury
1400 Pennsylvania Avenue, NW
Washington, DC 20224

Mr. Jason Smyczek
Office of Associate (Chief Counsel), International
Senior Technical Reviewer, Branch 4
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Mr. John Sweeney
Office of Associate (Chief Counsel), International
Branch Chief, Branch 8
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Recommendations on proposed regulations under section 1446(f)

Dear Gentlemen and Madam:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to submit comments on the proposed regulations under section 1446(f) of the Internal Revenue

[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.

Washington | New York

1101 New York Avenue, NW | 8th Floor | Washington, DC 20005-4269 | P: 202.962.7300 | F: 202.962.7305
www.sifma.org

Code.[2] SIFMA submitted comments to Notices 2018-08[3] and 2018-29[4] (the "Notices") in letters dated February 13, 2018 and August 2, 2018, regarding the withholding under new section 1446(f) on dispositions of certain partnership interests by foreign persons. We greatly appreciate the consideration of our comments in the drafting of the proposed regulations and the opportunity to comment further.

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 (or loss) 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 buyer/transferee of a partnership interest from a foreign person withhold 10 percent of the "amount realized" by the seller/transferor 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 buyer/transferee partner.

On December 29, 2017, the Department of the Treasury (the "Treasury") and the Internal Revenue Service (the "IRS") released Notice 2018-08, 2018-7 I.R.B. 352 suspending the requirement to withhold on dispositions of interests in publicly traded partnership ("PTP"s). On February 13, 2018, SIFMA submitted a letter requesting a permanent suspension of withholding for dispositions of interests in PTPs due to the significant practical problems referenced in Notice 2018-08 and requested guidance to address other operational challenges. On April 2, 2018, the Treasury Department and the IRS released Notice 2018-29, 2018-16 I.R.B. 495, which 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 distributions to new partners if those partners failed to withhold on the amount realized by the selling partners. On August 2, 2018, SIFMA submitted a letter that, among other requests, reiterated its request that Treasury use its regulatory authority under section 1446(f)(6) to indefinitely exclude dispositions of PTP interests from withholding. On May 13, 2019, the proposed regulations under section 1446(f) were published providing requirements for withholding on PTP interests with a proposed effective date of 60 days after the regulations are published as final.[5]

II. Recommendations for addressing the operational challenges of withholding on PTP dispositions

SIFMA seeks to provide the Treasury and the IRS with recommendations that will help make the withholding requirements relating to dispositions of PTP interests operationally administrable.

---

[2] 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.
[3] Notice 2018-08, 2018-7 IRB 352.
[4] Notice 2018-29, 2018-16 IRB 495.
[5] REG-105476-18.

Accordingly, we would reiterate the request to permanently suspend withholding for dispositions of interests in PTPs for the reasons articulated in SIFMA's previous letters. Considering that this request may not be adopted, SIFMA provides the following comments in response to the proposed regulations:

a. Extend the effective date from 60 days to 18 months following the finalization of all guidance

The proposed regulations provide that the paragraphs addressing the withholding requirements for transfers of interests in PTPs will have an effective date of 60 days after the finalization date.[6] Section 1446(f) introduces a new US withholding tax on gross proceeds paid to foreign persons requiring brokers to update systems, processes, and procedures in order to withhold in accordance with the new rules. Brokers have never before been asked to withhold on gross proceeds of a publicly traded security held by a foreign person and have never had to report such transactions on Form 1042-S. Generally and historically, SIFMA has advised Treasury and the IRS that withholding agents will require at least 18 months from the issuance of all final guidance, including the updated QI Agreement that incorporates section 1446 guidance, in order to design, build and implement the necessary system changes for a new withholding regime. For example, significant operational challenges to consider include:

- Security master systems do not uniformly capture PTP identifying information, requiring significant data quality procedures to be implemented,
- Transactional information regarding dispositions of PTPs is not captured for use in withholding calculations, and
- Updates will need to be made to obtain new information to be included on the qualified notice, which is not uniformly published.

These are a few of many tasks for which sufficient time is needed, specifically 18 months, to build and implement systems and procedures to meet the regulatory requirements.

b. Exception for COD and DVP transactions

Under the proposed regulations, a "broker" (including clearing organizations) that pays gross proceeds of a PTP sale to a "broker that is a foreign person" generally is required to withhold.[7] While the regulations do not explicitly state how to determine the US or foreign status of a broker for this purpose, presumably any broker that has not provided the paying broker a Form W-9 or other certification of non-foreign status is treated as foreign. These provisions create numerous operational issues.

Unlike the existing rules for information reporting and backup withholding on securities sales under sections 6045 and 3406, the proposed regulations would require withholding, including by executing brokers, on so-called "cash on delivery" ("COD") and "delivery versus payment" ("DVP")

[6] Prop. Reg. § 1.1446(f)-4(f)
[7] Prop. Reg. § 1.1446(f)-4(a)(2)

transactions[8]. The exception to backup withholding in these COD and DVP transactions is essential to proper operation of the securities market. If the full amount of proceeds is not delivered to the seller/transferor in a COD or DVP transaction, the trade "fails" and simply does not occur, with the securities going back to the seller/transferor's broker and the purchase money going back to the buyer/transferee's broker. The current information reporting and withholding regulations recognize that the disruption to the capital markets that could result from implementing gross proceeds withholding rules on and by executing brokers in COD and DVP transactions far outweighs the potential risk of non-compliance by a non-US broker.

Under current information reporting and withholding rules, the buyer/transferee's broker and any executing broker can rely on the COD/DVP exception and the multiple broker exception (Treas. Reg. § 1.6045-1(c)(3)(iii)) when making a payment to any broker to avoid both Form 1099-B reporting and backup withholding without the need for any tax documentation. In general, only the broker with the direct custodial relationship with the seller/transferor is required to issue a Form 1099-B and/or do backup withholding, meaning that the entire proceeds of the sale are paid to the seller/transferor's broker, regardless of how many intermediary parties there are and whether they are US or foreign. In our view, withholding is only appropriate when the selling/transferring partner is foreign, and the only party in a position to make that determination is the seller/transferor's custodial broker. In contrast, the proposed regulations require withholding at every segment of a transaction, unless either an exception to withholding applies or the paying broker has knowledge that withholding occurred upstream, without regard to whether the selling/transferring partner is a US or foreign person.

The approach of the proposed regulations can be anticipated to result in severe market disruption as trades fail at the DVP/COD stage and will lead to substantial overwithholding on undocumented brokers when trades do go through. We believe that the Treasury will achieve substantial compliance with section 1446(f) if, consistent with the current information reporting and backup withholding reporting rules, withholding on PTP dispositions is done by the custodial broker receiving the gross proceeds from a sale against delivery of the securities sold. The regulations should provide that withholding is to be performed by the custodial broker (US or foreign) who receives the gross proceeds on behalf of a selling/transferring partner. The regulations already provide that "brokers" who are obligated to withhold include both US and foreign brokers, just as the definition of "withholding agent" under section 1441 imposes a withholding duty on both US and foreign persons. See Treas. Reg. § 1.1441-7(a)(1). Accordingly, the we request that the final regulations include an exception for COD and DVP transactions in order to avoid disruptions to the operation of the securities market.

We also request that a broker be entitled to apply the chapter 3 presumption rules (which generally would result in a presumption of US status) to persons to whom PTP proceeds are paid. See Treas. Reg. § 1.1441-1(b)(3)(iii). We note this does not resolve the above concern regarding market disruption in a COD/DVP transaction when the broker for the seller is presumed foreign, so separate COD/DVP relief is also necessary, as discussed above. The request is made to enable a custodial broker (of which there may be several in a chain) to rely on its current process for gross proceeds withholding for purposes of section 1446.

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

c. Clarify the coordination of withholding under Sections 1446(a) and 1446(f)

The proposed regulations do not include a provision to clarify the withholding coordination between sections 1446(a) and 1446(f). It is our understanding that most distributions will be a distribution of current net income, and therefore withholding should not apply under section 1446(f), and withholding generally would be limited to sections 1441, 1442, 1443, and/or 1446(a). The application of withholding on the distribution as an allocation of income and simultaneously as a disposition is both operationally complex and will likely result in excessive withholding. We request that section 1446(f) withholding not apply on distributions to which section 1441, 1442, 1443, or 1446(a) already applies. The withholding tax already imposed on a distribution should be sufficient and the withholding system should not be unnecessarily complicated by duplicative withholding.

d. Revise the qualified notice exception to treat a distribution as made out of current net income, unless otherwise stated

If a distribution is not exempted from section 1446(f) withholding (see above request), we request that the final regulations require a PTP to state in the qualified notice when a distribution is <u>not</u> made out of current net income and otherwise, the broker should be able to treat the distribution as made out of current net income. The proposed regulations provide two exceptions to withholding under section 1446(f) that apply if and only if the PTP issues a qualified notice with certain specific representations. First, a PTP may certify in a qualified notice that a sale of all of its assets on a date designated by the PTP would result in less than 10 percent of the gain being effectively connected with a US trade or business or no gain being effectively connected.[9] If such a qualified notice has been issued in the 92 days preceding a transfer of a PTP interest, a broker need not withhold with respect to a transfer (including a distribution treated as a transfer).[10] With respect to the 92 day period, we request a 183 day period as qualified notices received late in the calendar year complicate the withholding and reporting process. Second, a PTP may certify in a qualified notice that a distribution is made out of net income received since the record date of its last distribution, preventing characterization of the distribution as a transfer and likewise turning off the requirement to withhold.[11]

PTPs that issue a false qualified notice are required to withhold on distributions to the transferee in an amount equal to any underwithholding by brokers (hereinafter referred to as "backstop withholding").[12] Backstop withholding by PTPs for false qualified notices raises numerous questions. It is unclear, for example, whether a qualified notice that is merely erroneous is "false," or whether the proposed regulations intend to reach only willfully false statements. In actual operation, it appears unlikely that a PTP will actually backstop withhold on a distribution because it may not realize its error until later and, even if it wants to take responsibility for the error, it almost certainly cannot identify the relevant transferee or know whether a broker, in fact, underwithheld. The uncertainty over these provisions may cause some PTPs to simply refuse to issue qualified notices so that there is no possibility of a "false" qualified notice.

---

[9] Prop. Reg. § 1.1446(f)-4(b)(3)
[10] Prop. Reg. § 1.1446(f)-4(b)(3)(iii)(B)
[11] Prop. Reg. § 1.1446(f)-4(b)(4)
[12] Prop. Reg. § 1.1446(f)-3(b)(2)(ii)

Our members believe that Treasury and the IRS can make changes to the qualified notice provisions to improve their practical operation. If distributions are not exempted from section 1446(f) withholding, we request that a broker be able to treat the distribution as made out of current net income unless the PTP includes a statement in the qualified notice that the distribution is not made out of current net income, since that appears to be the exceptional case. Otherwise, the broker should be able to treat the distribution as made out of current net income. It will be difficult enough to explain to customers why we are withholding on gross proceeds of PTP sales; and we believe it will be extraordinarily difficult to explain to customers why brokers are required to withhold on distributions as if they are transfers. Accordingly, reducing the possibility of section 1446(f) withholding on distributions is important to reduce the administrative costs imposed on brokers.

e. Eliminate the backstop withholding provision for PTP distributions

In addition, given the impracticality of actually computing the underwithholding caused by a false PTP qualified notice which we suspect will be a deterrent to partnerships that might wish to issue the qualified notice information for section 1446(f) purposes, we recommend that the regulations instead impose an information return penalty in such situations. Such a penalty may be imposed with respect to "any form, statement, or schedule required to be filed with the Secretary … with respect to any amount from which tax was required to be deducted and withheld under chapter 3." See IRC section 6724(d)(1) (flush language). Section 1446 is covered by this language because it is part of chapter 3. The regulations could treat a qualified notice in a manner similar to Form 8937, i.e., nominally require filing of the notice with the IRS, but treat the publication of the notice on the PTP's web site as a deemed filing. See Treas. Reg. § 1.6045B-1(a)(3). Failure to file or publish the notice, or publication of an erroneous notice, would be subject to the penalty under section 6721.

f. Clarification that the highest rate should also apply when no qualified notice is published

The proposed revision to Treas. Reg. § 1.1446-4(d) provides that a nominee should withhold at the highest rate specified in section 11(b) or 881[13] for a partner that is a foreign corporation, or the highest rate specified in section 1 or 871 for a foreign partner that is not a corporation, if "a notice a publicly traded partnership issues relating to its distribution does not meet the requirements" in the regulations.[14] In other words, brokers should withhold at the highest rate if there is a qualified notice that is faulty. It is unclear whether the rule also applies if no qualified notice is published, although that does appear to be the intent expressed in the preamble. The final regulations should clarify that the same rule that applies to a defective qualified notice applies when there is no qualified notice.

Our members also seek clarification on the highest rate specified. We believe that the highest rate specified means the highest rate applicable to the partner, i.e., taking into account treaty reductions

---

[13] In addition, we note the lack of coordination with chapter 4 withholding. Proceeds from a transfer of a PTP interest are not a "withholdable payment" for chapter 4 withholding purposes. However, a distribution could be a transfer and could also include a chapter 4 withholdable payment. Therefore, to the extent such a distribution is (or is deemed to be) paid to a person subject to withholding under chapter 4, it would seem that the nominee must treat the distribution as a withholdable payment under chapter 4.

[14] Prop. Reg. § 1.1446-4(d)(1)&(2)

rather than simply applying the statutory rate of 30 percent. For example, a partner that is a corporation for US tax purposes may provide documentation (such as a treaty claim) to support a reduced rate of withholding on US source fixed or determinable or periodical ("FDAP") income that is less than the 21 percent rate that applies to effectively connected income; and it is our understanding that the rate that would apply to the corporation for a distribution with a defective or missing qualified notice would be the 21 percent rate that applies to effectively connected income (which is greater than the lower treaty rate applicable to the specific client). It would not be the unreduced rate of 30 percent on US source FDAP income hypothetically applicable to a non-treaty client. This example presumes that our recommendations above to eliminate duplicative withholding and to provide for a presumption that a distribution as made out of current net income are adopted.

g. Clarify the date withholding is required

While a transfer of a PTP interest occurs on the date of the trade, the final regulations should clarify that settlement date is when withholding is required (when cash becomes available to withhold upon), consistent with the backup withholding rule in Treas. Reg. § 31.3406(a)-4(b)(1).

III. Recommendations related to Qualified Intermediaries ("QI") and Withholding Foreign Partnerships and Trusts ("WP"/ "WT")

Under the proposed regulations, a QI has the ability to assume primary withholding responsibility for the payment of proceeds on a PTP interest.[15] The preamble also provides that Treasury and the IRS intend to modify the QI agreement to allow QIs to assume primary withholding responsibility under section 1446.[16] We request that this election to assume primary withholding responsibility under section 1446, for both distributions and transfers, be a separate election from the election to assume primary withholding responsibility on FDAP income. Further, if a QI elects not to assume primary withholding responsibility under section 1446, the QI should be able to choose to act as a nonwithholding QI with respect to section 1446 (i.e., provide the upstream withholding agent with pooled information) or to act as a non-qualified intermediary ("NQI") (i.e., separately identify each customer to whom a payment of proceeds should be allocated, along with allocation information). Consistent with our request below, both a nonwithholding QI and an NQI should be permitted to provide information on US persons so that a "modified amount realized" can be calculated.

Our members also request that QIs, due to local law privacy issues, be permitted to pool report on Form 1042-S consistent with the current QI Agreement and provide specific recipient Forms 1042-S upon request. While we appreciate that the partners may have a US tax return filing requirement, in many jurisdictions the local law prohibits filing specific recipient US information returns without an explicit request from the recipient. For administrative ease and to ensure compliance with local law requirements, we request a continuation of the ability to pool report even for proceeds subject to withholding under section 1446(f) unless a specific recipient Form 1042-S is requested by the recipient.

Additionally, the we request that the final regulations provide that the withholding foreign partnership and trust agreements apply to section 1446.

15 Prop. Reg. 1.1446(f)-4(a)(2)(i)

16 Preamble to Prop Regs. 05/13/2019. Fed. Reg. Vol. 84, No. 92 p. 21198, Section V.A

IV. Recommendations for documentation

a. Withholding statements of NQIs and non-withholding foreign partnerships and trusts

Section 1.1446(f)-4(c)(2)(ii) of the proposed regulations permits a foreign partnership that is a transferor to provide a certification to the broker with respect to the portion of the proceeds allocable to its US partners. In turn, the broker is required to withhold only on the "aggregate percentage" of gross proceeds allocable to the foreign partners. The certification is required to include certifications of non-foreign status (such as Forms W-9) from each direct or indirect US partner, as well as an allocation of the proceeds to each direct or indirect US partner.[17]

An NQI should also be permitted to provide the same certification so that a "modified amount realized" can be calculated in a manner similar to the method that applies to foreign partnerships. Withholding on PTP proceeds that an NQI can allocate to US persons clearly would be excessive.

In addition, we are concerned that the modified amount realized provisions may have the unintended consequence of requiring Form 1099-B reporting by brokers with respect to the US partners. Under a longstanding presumption rule in Treas. Reg. § 1.6049-5(d)(3)(ii), brokers are permitted to presume that the partners of a foreign partnership and customers of an NQI are exempt recipients (i.e., exempt from Form 1099 reporting) unless two conditions are met: (1) the broker has actual knowledge that there is a US partner or customer and (2) the broker has actual knowledge of the amount allocable to that US partner or customer. Inasmuch as the section 1446(f) regulations are not concerned with the issuance of Forms 1099-B, it appears that the potential clash with the presumption of exempt recipient status is inadvertent. Moreover, it is unclear why partner-specific allocations to US partners are necessary given that there is no section 1446(f) withholding and no need to report under section 1446(f) with respect to US partners.

There are two potential ways to avoid inadvertent triggering of the requirement of Forms 1099-B, the first of which would be our preferred approach as it would impose no administrative burden on withholding agents:

1. Provide a specific override of Treas. Reg. § 1.6049-5(d)(3)(ii). The final regulations could provide, for example, that a certification under section 1.1446(f)-4(c)(2)(ii)(C) applies solely for the purpose of determining section 1446 withholding and shall be disregarded for purposes section 6045.
2. Allow the partnership's or NQI's withholding statement to include a separate proceeds allocation to US partners on an aggregate basis, rather than assigning a specific allocation to each US partner.

b. *Form W-8ECI exemption*

[17] Prop. Reg. § 1.1446(f)-4(c)(2)(ii)(C)

A selling/transferring partner should be exempt from withholding under section 1446(a) and (f) if a valid Form W-8ECI, Certificate of Foreign Person's Claim That Income Is Effectively Connected With the Conduct of a Trade or Business in the United States, is provided designating the income as effectively connected income.

c. *Clarification on the information required on a selling/transferring partner's Form W-8 when claiming treaty benefits pursuant to section 1446(f)*

We request that the IRS clarify whether an express statement is required for special rates and conditions that may apply to gains derived by a resident of a contracting state. It is our understanding that the applicability of treaty claims to an interest in a PTP may be uncommon and may apply to one partnership interest but not another depending, for example, on whether the partnership has a US permanent establishment. Based on this understanding, we request that the instructions to the Forms W-8 include detailed information on circumstances in which a treaty claim may be appropriate and the information necessary to make a valid treaty claim with respect to section 1446(f).

V. *Information reporting*

There are a number of information reporting issues which we believe can be handled with a brief discussion. The final regulations should clarify the following:

i. If a foreign partnership transfers a PTP interest, the foreign partnership will receive a Form 1042-S and such form should be permitted to be used to claim a credit against its own liability to withhold under section 1446(a).
ii. Regulations should clarify that PTP sales by a customer for a calendar year may be reported, in aggregate, on a single Form 1042-S, provided that the broker makes transactional information available to the customer (for example, in the form of accounts statements) upon request.
iii. Regulations should clarify that if an NQI is subject to withholding on PTP sales proceeds (assuming, consistent with the request above, that this would apply when the NQI does not provide recipient specific information), the reporting is to an unknown recipient (since it is likely that the NQI is acting on behalf of some other person).

We further note that the current guidance on Schedule K-1 reporting to holders of partnership interests held through nominees and the current state of such process does not ensure that the IRS (and taxpayer) receive accurate information to confirm the amount of ECI gain and may create difficulties for taxpayers and the IRS in calculating the liability under section 864(c)(8) and the associated refund claim, if any.

VI. *Limitation of section 1446(f) to physical interests in partnerships*

Based on the history behind the enactment of Section 1446(f) and the substance of the accompanying regulations, we believe it is clearly the intent that the proposed 1446(f) regulations apply only to physical interests in a partnership and not synthetic interests (e.g., derivatives referencing MLPs or other PTPs). For the avoidance of doubt, however, SIFMA members request confirmation that an interest in a partnership for purposes of section 1446(f) and the accompanying regulations does not include a synthetic interest in a partnership. Section 1446(f)(1) imposes withholding tax with respect to "the gain (if any) on any disposition of an interest in a partnership [that] would be treated under section 864(c)(8) as effectively connected with the conduct of a trade or business within the United States." Section 864(c)(8)(A) states that "if a nonresident alien individual or foreign corporation owns, directly or indirectly, an interest in a partnership which is engaged in any trade or business within the United States, gain or loss on the sale or exchange of all (or any portion of) such interest shall be treated as effectively connected with the conduct of such trade or business to the extent such gain or loss does not exceed the amount determined under subparagraph (B)." While we view this language as applying only to interests held by actual partners in a partnership, we would like to confirm that section 1446(f) is intended to only apply to physical partnership interests and not derivative interests.

VII. Conclusion

We appreciate your consideration of our concerns, and we would like the opportunity to discuss the issues in this submission with you and your colleagues. Please don't hesitate to contact me at (202) 962-7300 or ppeabody@sifma.org, or SIFMA members' 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 or (202) 327-5725.

Sincerely,

Payson R Peabody

Payson Peabody
Managing Director & Tax Counsel
SIFMA