December 20, 2019

Mr. Chip Harter
Deputy Assistant Secretary
International Tax Affairs
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20224

Ms. Erika Nijenhuis
Senior Counsel, Office of Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20224

Ms. Kamela Nelan
Attorney-Advisor, Office of Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20224

Mr. Ronald Gootzeit
Office of Associate (Chief Counsel), International
Counsel, 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 Madams:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to further respond to the request for comments in the Notice of Proposed Rulemaking under Section 1446(f)[2] relating to transfers of interests in publicly traded partnerships ("PTPs") by

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

foreign persons. On July 15, 2019, SIFMA submitted comments to the proposed regulations (the "Prior Letter")[3], which were discussed at a meeting between SIFMA members and individuals from the IRS and Treasury on August 8, 2019. We greatly appreciate your time and efforts in meeting with us and have prepared this letter to address certain questions and concerns raised at the meeting.

1. Delivery versus payment and similar transactions

The Prior Letter expressed our significant concerns regarding the potential impact of the proposed regulations on delivery versus payment (DVP) transactions. In response to your request for further information regarding DVP transactions, we are providing the additional background information below as well as the attached diagram, and we also reiterate below our requests and recommendations with respect to section 1446(f) and DVP transactions.

a. Background on DVP transactions

Owners of PTP interests generally hold their interests through a custodial financial institution. When holders sell their PTP interests, there could be several brokers involved in the clearing and settlement of the trade or a single broker could assume multiple roles. For instance, the executing broker routes the order, a clearing broker clears the trade through the clearing organization (e.g., DTC) and the custodian (and possibly a sub-custodian) receives the cash proceeds on the seller's behalf at settlement.

By trade date, the executing broker for the seller will set up a DVP account. The DVP account will typically contain standing instructions from the account holder (which may be an investment manager and not the seller/beneficial owner) to send proceeds to, and receive securities from, a designated institution (i.e., the PTP seller's custodian). In cases where the investment manager is the DVP account owner, the executing broker generally is not required to know name of the beneficial owner of the PTP interest being sold in order to transact with the designated institution identified in the DVP account instructions. Accordingly, in such cases, the executing broker may not know the identity of the ultimate beneficial owner of the PTP interest being sold, and generally would not require that any KYC/AML processes be applied with respect to the beneficial owner.[4]

b. Requests/recommendations with respect to DVP transactions

The proposed regulations require withholding by any "broker" (which is defined to include clearing organizations) that receives an amount realized from the sale against delivery of the PTP interest unless an exception applies. Consistent with our Prior Letter, we request that for DVP and similar transactions, the final regulations provide that the custodial broker (whether U.S. or foreign) who receives the gross proceeds from the sale of the PTP from the clearing organization be the broker

---

[2] REG-105476-18. All "section" references in this letter refer to the Internal Revenue Code of 1986, as amended.

[3] https://www.sifma.org/wp-content/uploads/2019/07/SIFMA-Letter-1446-2019-07-15-final.pdf

[4] If the beneficial owner of the PTP does not have an investment manager and appoints the executing broker directly, then the DVP account would be in the name of the beneficial owner, and the beneficial owner would be subject to the executing broker's KYC/AML procedures.

solely responsible for collecting withholding tax under section 1446(f), unless the proceeds are paid to another broker that has assumed primary withholding responsibility. Under this approach, the definition of "broker" under Prop. Treas. Reg. § 1.1446(f)-1(b)(1) would remain unchanged, but only the custodial broker that receives the gross proceeds from the sale of the PTP would be required to withhold under section 1446(f) unless the proceeds are paid to another broker that has assumed primary withholding responsibility (in which case that second broker would be the required to withhold under section 1446(f)). Accordingly, under this approach, the executing broker would not be required to withhold under section 1446(f).

Ultimately, this recommendation is consistent with the regulations under section 6045 which provide in Treas. Reg. § 1.6045-1(c)(3)(iv) that "only the broker that receives the gross proceeds from the sale against delivery of the securities sold is required to report the sale" and if "the broker's customer is another broker (second-party broker) that is an exempt recipient,[5] then only the second-party broker is required to report the sale." If this recommendation is adopted, SIFMA requests that the regulations clearly indicate that it is the *custodial* broker who is required to withhold unless the sales proceeds are paid to another custodial broker that assumes primary withholding responsibility. While SIFMA appreciates that in some instances the custodial broker receiving proceeds from the clearing organization could be a non-qualified intermediary ("NQI"), we believe these instances would be infrequent[6] and should not outweigh the operational complexities and market concerns articulated in our Prior Letter. We further request that the regulations include examples similar to Treas. Reg. 1.6045-1(c)(4), Examples 3 through 5, to explain that the custodial broker that receives the gross proceeds from the sale of the PTP has the primary withholding and reporting obligation, and not the executing broker.[7]

As an alternative, SIFMA requests that the regulations exclude an executing broker from the definition of broker under Prop. Treas. Reg. § 1.1446(f)-1(b)(1) for the reasons described above and in our Prior Letter. Apart from the exclusion of executing brokers, the definition of "broker" would otherwise remain unchanged from the proposed regulations under this alternative approach and would include clearing organizations. Accordingly, under this alternative, the clearing organization (e.g., DTC) would have primary withholding responsibility with respect to section 1446(f) unless the proceeds are paid to a broker that is a U.S. person or a non-U.S. person that assumes primary withholding responsibility. We believe that, consistent with the proposed regulations' approach in treating clearing organizations as brokers, it would be appropriate for DTC to be the withholding agent in this case given DTC's central role and given that DTC generally collects U.S. tax documentation from its participants.

---

[5] Under Treas. Reg. § 1.6045-1(c)(3)(i)(B), exempt recipients include both foreign corporations and securities dealers (wherever organized) that are registered as such under U.S. or state law.

[6] See DTCC's letter to the Treasury Department and IRS, dated August 15, 2019, re: Comments on proposed Section 1446(f) Regulations, which states on p. 6 that "DTC has a very minimal number of non-U.S. clients that are not a U.S. branch of a foreign bank or a QI."

[7] We note that Example 4 indicates that the beneficial owner D (rather than the investment advisor E) is the executing broker K's named client. Market practice, as described in the text, is that the investment manager is the executing broker's client, not the beneficial owner.

As discussed in our Prior Letter, SIFMA members have significant concerns with any approach under the section 1446(f) regulations that would require the executing broker for a DVP transaction to act as a withholding agent.[8] DVP accounts are set up to facilitate trade settlement and are not set up or documented like custodial accounts. Unlike custodial accounts, DVP accounts are not designed to safekeep assets or receive income on those assets on behalf of customers, and DVP accounts are not set up for any kind of U.S. tax information reporting because of the exemption provided under Treas. Reg. § 1.6045-1(c)(3)(iv). In cases where the beneficial owner of the PTP has appointed an investment manager, DVP accounts are set up in the name of the entity that appointed the executing broker, and not the beneficial owner of the PTP being sold. For this reason, SIFMA requests that the regulations exclude an executing broker from the definition of broker under Prop. Treas. Reg. § 1.1446(f)-1(b)(1).

2. Confirmation of no 1446 withholding or reporting responsibility for NQI that fully discloses

In the Prior Letter, SIFMA requested that an NQI be permitted disclose the beneficial owners to an upstream withholding agent so that withholding is applied only to interest holders that are non-U.S. persons. We would like to emphasize that this is operationally feasible in instances in which the NQI that fully discloses the non-U.S. beneficial owner through a segregated account (or by otherwise providing allocation information) to an upstream withholding agent. Accordingly, SIFMA requests that the regulations allow an NQI to disclose the owners of PTP interests to an upstream withholding agent in order to transfer all section 1446 withholding and reporting responsibilities to that upstream withholding agent.[9]

3. Nominee reporting

Transferors of partnerships interests, including PTP units, will require the information from the partnership to complete their own U.S. income tax returns. We noted in our Prior Letter that the current process to enable PTPs to issue Schedules K-1 "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." That process was originated with Treas. Reg. § 1.6031(c)-1T, a "temporary" regulation published in 1988. Most brokers submit a template with their positions to a single vendor, which compiles the data and provides it to each PTP. In some cases, the reported data does

[8] Under the proposed section 1446(f) regulations, "[t]he term *broker* means any person, foreign or domestic, that, in the ordinary course of a trade or business during the calendar year, stands ready to effect sales made by others, and that, in connection with a transfer of a PTP interest, receives all or a portion of the amount realized on behalf of the transferor." Prop. Treas. Reg. § 1.1446(f)-1(b)(1). As described in the attached diagram, the executing broker executes the PTP sell order on the exchange and receives sales proceeds, which, at a high level, are then transmitted to the designated institution (e.g., the seller's custodian) via a transfer between the parties' accounts at DTC. Because the executing broker may receive sales proceeds from executing the PTP sell trade, an executing broker arguably may meet the definition of "broker" under the proposed regulations.

[9] As mentioned in our Prior letter, we request that that the disclosure of the beneficial owners not result Form 1099-B reporting by brokers with respect to the U.S. partners under the longstanding presumption rule in Treas. Reg. § 1.6049-5(d)(3)(ii).

not seem consistent with information known about the relevant PTP, for example, showing that more units are owned by partners than have been issued by the PTP. In some cases, it appears that PTPs accept the data without rationalizing it against their own records. The need for accurate partner data for section 864(c)(8) purposes makes it an opportune time for the IRS and Treasury to review and update the process.

4. Withholding on distributions

We continue to believe that withholding under section 1446(f) on PTP distributions to foreign investors is excessive and will deliver very little value to the government while imposing disproportionate costs on the brokers who are required to withhold.

First, the PTP's taxable income is already subject to withholding on distribution to the extent it is subject to U.S. tax in the foreign partner's hands. U.S. source income, such as dividends from a PTP's investments in U.S. corporations, would be subject to withholding under sections 1441 and 1442 (and subject to tax under sections 871(a) and 881), and effectively connected taxable income allocated to a foreign partner is subject to withholding under section 1446(a) (and subject to tax under sections 871(b) and 882). To the extent a distribution consists of items that are not subject to U.S. tax withholding, such as returns of capital from investments made by the PTP, those items are not themselves subject to any substantive tax for the foreign investor to pay, and, as we explain next, possibility of liability under section 864(c)(8) appears remote.

Second, withholding under section 1446(f) should be imposed on a distribution only if there would be a substantive tax due from the investor under section 864(c)(8). There is a weak case that such tax will be due on the vast majority PTP distributions. For substantive tax to be imposed, an event that is treated as "sale or exchange" of a partnership interest must occur. That would happen on a distribution by a PTP only to the extent that the distribution exceeded the investor's basis. Basis would include the purchase price of the investor's PTP units plus the investor's share of income earned by the partnership while the investor owned the units[10] minus distributions by the PTP to the investor.[11] The ratio of a PTP's annualized distributions to its unit price (referred to as "dividend" yield even though the distributions are not dividends for tax purposes) would need to be very high, and combined with a history of minimal earnings or losses, in order for a distribution to exceed an investor's entire basis and trigger sale or exchange treatment.

Third, the government will eventually be paid. Withholding under section 1446(f) will apply when the investor ultimately disposes of its interest in the PTP, at which point any section 864(c)(8) liability for the investor will unambiguously be triggered and the withholding will act as a credit

[10] The proposed regulations provide an exception to withholding on a distribution when the PTP publishes a qualified notice that a distribution is out of current income, on the theory that it is not possible for such a distribution to exceed an investor's basis. See Prop. Treas. Reg. § 1.1446(f)-4(b)(4). This relief is inadequate because (1) it fails to account for the investor's purchase price as a part of basis, and (2) it relies on PTPs to volunteer information and accept liability if the qualified notice is false, which they may be reluctant to do.

[11] Brokers are not required to track investors' bases in their PTP investments, and obtaining basis information or a certification of no realized gain as provided for by Prop. Treas. Reg. § 1.1446(f)-2(b)(3) in the non-PTP context would be impractical in the PTP world.

against any tax, as intended. Any unrealized gains on partnership assets that existed at the time of earlier distributions either (1) will have been realized and subjected to U.S. tax as effectively connected income subject to section 1446(a) withholding in the year of realization or (2) will remain unrealized and subject to U.S. tax under section 864(c)(8) and section 1446(f) withholding in the year of the disposition. In other words, the government will collect the correct amount of tax in the overwhelming number of cases if it does not require withholding on distributions. In most cases withholding on distributions would result in either the government keeping the withholding despite the lack of any tax being due, or foreign investors being put to the expense of filing refund claims in which they prove their basis. Both of these outcomes should be avoided.

Finally, building systems to withhold on distributions will require a substantial investment. The proposed regulations would require that section 1446(f) withholding be done in addition to any other required withholding on the distribution. Effectively, the same distribution would need to go through withholding process twice. This would be unique in the universe of withholding taxes and require a sophisticated withholding tax system logic. Another complication is that undocumented individuals would be subject to two different rates – 24% under section 3406 in the event of a disposition and 10% in the event of a distribution. Even if the withholding is limited to the portion of the distribution not otherwise subjected to withholding, brokers would still need to determine that amount, and that process also would be specific to PTP distributions. Reporting distributions on Form 1042-S and accounting for the tax on Form 1042 also would require unique logic.

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

As stated in our Prior Letter, we believe the proposed section 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, we request that Prop. Treas. Reg. 1.1446(f)-1(b), when finalized, clarifies that the “term *interest* when used in reference to a partnership refers to an interest as a partner in the partnership.”

6. Require PTP’s to provide their Qualified Notices to their registered shareholders

SIFMA recommends that PTPs provide a copy of the qualified notice to its registered holders. In most cases the nominee is DTC’s nominee Cede & Co. As is the case today for corporate actions, DTC disseminates information throughout the participants in capital markets using its systems and processes.

7. 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 further. Please don't hesitate to contact me at JWall@SIFMA.org or (202) 962-7440 our outside counsels Tara Ferris and 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.

Respectfully submitted,

Jamie Wall

Jamie Wall
Executive Vice President, Advocacy