DISPOSITION OF A PARTNERSHIP INTEREST NOW SUBJECT TO TAX WITHHOLDING

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By: Charles H. Purcell, Won-Han Cheng, Elizabeth C. Crouse

The new Tax Cut and Jobs Act of 2017 (the "Act") contains a provision that is of great importance to any persons buying or selling an interest in a partnership. New Section 864(c)(8) of the U.S. Internal Revenue Code (the "Code") makes clear that if a foreign person sells an interest in any U.S. or non-U.S. partnership (or other entity that is treated as a partnership for U.S. federal income tax purposes) that is engaged in a U.S. trade or business, then any gain that is attributable to the partnership's U.S. trade or business is treated as effectively connected to a US trade or business and subject to U.S. federal income tax.

More importantly, as of January 1, 2018, a purchaser of a partnership interest is generally required to withhold 10% of the amount realized on the disposition (typically, the purchase price of the interest) and remit such amount to the IRS under new Section 1446(f) of the Code. Again, this rule applies to sales of **both U.S. and non-U.S. partnerships** that are engaged in a US trade or business.

Withholding is required unless (i) the purchaser receives an affidavit from the seller to the effect that it is a U.S. person (including the taxpayer identification number of the seller) (a "U.S. Affidavit"), (ii) it is determined that no portion of the gain recognized is attributable to a U.S. trade or business, (iii) the IRS agrees to a lower withholding amount (a process which could take months), or (iv) pursuant to Notice 2018-08, released on December 29, 2017, interests in the relevant partnership are publicly traded. If the purchaser does not withhold when required, the partnership is required to withhold from distributions to the purchaser an amount equal to the under-withholding plus interest. Presumably, the partnership will be liable for such amounts if it fails to withhold.

This requirement applies apparently even if only a *de minimis* amount of the partnership income is effectively connected with a U.S. trade or business. Thus, a partnership interest that would generate $1 of effectively connected income for a partner and sold for $100,000 could be subject to a 10% withholding tax ($10,000) on sale. Although not expressly stated in the new provision, it appears that the transferor could seek a refund to the extent any withholding exceeds the transferor's U.S. federal income tax liability.

It is often difficult to determine whether a partnership is engaged in a U.S. trade or business.

- Accordingly, a purchaser of U.S. or foreign partnership interests should obtain a U.S. Affidavit from a seller or obtain appropriate assurances from the seller that the partnership is not engaged in a U.S. trade or business. In cases where the risk is large, purchasers should consider a guarantee of any resulting liability.

- Partnerships should ensure that they are (i) aware of all transfers of their partnership interests and (ii) able to determine whether any transfers that do occur comply with these new rules.
- General partners and managers should be especially careful regarding any consent to transfer that they provide to their investors given this new provision.

Although the statute does not provide for a process whereby the partnership or the transferor partner can certify that no portion of the gain recognized is attributable to a U.S. trade or business, the IRS has specific authority to implement the withholding provision. Therefore, the IRS may provide for a certification process that could provide greater comfort to transferees.

It is not clear how U.S. federal tax treaties may impact this withholding. U.S. tax treaties typically exclude income earned from a U.S. trade or business if the person that earns the income does not have a "permanent establishment" in the United States. The definition of permanent establishment is complex, but it can generally be thought of as an ongoing physical presence of the taxpayer or certain types of agents of the taxpayer. Thus, even if a non-U.S. person holds an interest in a partnership that holds assets in a U.S. trade or business, the non-U.S. person should not be subject to the tax or withholding described above if the non-U.S. person qualifies for the benefits of a relevant tax treaty and the partnership does not have a permanent establishment in the United States.

However, under generally applicable U.S. tax law, new domestic laws override the provisions of existing treaties. It is not unprecedented for a newly enacted law to conflict with a prior tax treaty, but managing the conflict is generally determined after significant negotiation between the United States and relevant treaty countries. Given the negative statements made by many treaty countries about the Act in recent weeks, it is difficult to be certain how or whether the Internal Revenue Service will enforce the new tax and withholding requirements in the case of any non-U.S. person that claims the benefits of a tax treaty on the grounds that any gain that would be subject to the new tax is not connected with a U.S. permanent establishment.

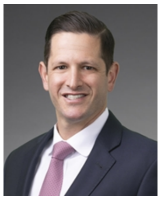
KEY CONTACTS

CHARLES H. PURCELL
PARTNER

SEATTLE
+1.206.370.8369
CHARLES.PURCELL@KLGATES.COM

WON-HAN CHENG
PARTNER

SEATTLE
+1.206.370.8331
WON-HAN.CHENG@KLGATES.COM



ADAM J. TEJEDA
PARTNER

NEW YORK
+1.212.536.4888
ADAM.TEJEDA@KLGATES.COM

J. STEPHEN BARGE
PARTNER

PITTSBURGH
+1.412.355.8330
STEVE.BARGE@KLGATES.COM

MARY BURKE BAKER
GOVERNMENT AFFAIRS COUNSELOR

WASHINGTON DC
+1.202.778.9223
MARY.BAKER@KLGATES.COM