DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 301

[REG–108524–00]

RIN 1545–AY28

Section 1446 Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations regarding the obligation of a partnership to pay a withholding tax on effectively connected taxable income allocable under section 704 to a foreign partner. The regulations will affect partnerships engaged in a trade or business in the United States that have one or more foreign partners.

DATES: Written or electronic comments and requests to speak, with outlines of topics to be discussed at the public hearing scheduled for December 4, 2003, must be received by November 13, 2003.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–108524–00), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–108524–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at *http://www.irs.gov/regs.* The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, David J. Sotos, at (202) 622–3860, or to be placed on the attendance list for the hearing, LaNita Van Dyke at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collections of information should be received by November 3, 2003. Comments are specifically requested concerning:

Whether the proposed collections of information are necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collections of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collections of information in this proposed regulation are in §§ 1.871–10, 1.1446–1, 1.1446–3, and 1.1446–4. This information is required to determine whether a partnership is required to pay a withholding tax with respect to a foreign partner and provide information concerning the tax paid on such partner's behalf, and to determine the foreign person required to report the effectively connected taxable income earned by such partnership and entitled to claim credit for the withholding tax paid by the partnership. This information will be used in issuing refunds to foreign persons claiming credit for withholding tax paid on their behalf, as well as for audit and examination purposes. The reporting requirements in §§ 1.871–10 and 1.1446–3 are mandatory. The reporting requirement in § 1.1446–1 and 1.1446–4 are voluntary. The likely respondents include individuals, business or other for-profit institutions, and small businesses or organizations.

Estimated total annual reporting burden: 7,805 hours.

Estimated average annual burden hours per respondent: 0.5 hours.

Estimated number of respondents: 15,775.

Estimated annual frequency of responses: on occasion and quarterly.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains proposed amendments to 26 CFR part 1 under section 1446 of the Internal Revenue Code (Code). Section 1446 was added to the Code by section 1246(a) of the Tax Reform Act of 1986 (Public Law 99–514, 100 Stat. 2085, 2582 (1986 Act)), to impose withholding at a rate of 20 percent on distributions to a foreign partner by a partnership that was engaged in a U.S. trade or business. Section 1012(s)(1)(A) of the Technical and Miscellaneous Revenue Act of 1988 (Public Law 100–647, 102 Stat. 3342, 3526 (1988 Act)) revised section 1446 to require that a withholding tax (1446 tax) be imposed on effectively connected taxable income (ECTI) allocable to a partner that is a foreign person (foreign partner) at the highest tax rate applicable to such person. Finally, section 7811(i)(6) of the Omnibus Budget Reconciliation Act of 1989 (Public Law 101–239, 103 Stat. 2106, 2410 (1989 Act)), made certain technical amendments to section 1446.

Treasury and the IRS issued Rev. Proc. 88–21 (1988–1 C.B. 777) to provide guidance on the operation of the withholding tax imposed under section 1446 as enacted by the 1986 Act. After the 1988 Act, which revised the withholding approach to apply to a partner's allocable share of ECTI instead of to distributions, Treasury and the IRS published Rev. Proc. 89–31 (1989–1 C.B. 895), which made Rev. Proc. 88–21 obsolete. Rev. Proc. 89–31 was modified by Rev. Proc. 92–66 (1992–2 C.B. 428). Rev. Proc. 89–31, as modified by Rev. Proc. 92–66, provides current guidance to partnerships for calculating, paying over, and reporting the 1446 tax.

Explanation of Provisions

A. In General

Prior to the enactment of section 1446, a partnership generally was not required to withhold on income that was effectively connected with the conduct of a trade or business within the United States (a U.S. trade or business) and allocated or distributed to its foreign partners. Congress enacted section 1446 because it was concerned that passive foreign investors could

escape U.S. tax on their partnership income. See S. Rep. No. 99–313, 99th Cong., 2d Sess. 414 (1986). As originally enacted, section 1446 generally required both domestic and foreign partnerships with any income, gain, or loss that was effectively connected with the conduct of a U.S. trade or business to withhold a tax equal to 20 percent of any amount distributed to a foreign partner. Through a series of modifications and refinements discussed below, this withholding tax regime evolved from its original structure of withholding on distributions to foreign partners to its present form of, generally, withholding on an installment basis on partnership ECTI (whether distributed or not distributed), apart from special provisions for publicly traded partnerships.

In response to the enactment of section 1446, Treasury and the IRS issued Rev. Proc. 88–21 to provide guidance for partnerships to comply with section 1446. After Rev. Proc. 88–21 was issued, the 1988 Act amended section 1446 retroactively and provided that no withholding was required under section 1446 for partnership taxable years beginning before January 1, 1988.

Section 1446, as revised by the 1988 Act, shifted from imposing a withholding tax on partnership distributions to imposing a withholding tax on the amount of ECTI allocable to the partnership's foreign partners. More specifically, section 1446(a) requires partnerships that have ECTI in any taxable year, any portion of which is allocable under section 704 to a foreign partner, to pay the 1446 tax at such time and in such manner as prescribed in regulations. The amount of withholding tax payable by a partnership under section 1446 is equal to the applicable percentage of the partnership's ECTI allocable under section 704 to foreign partners. The applicable percentage for ECTI allocable to a foreign corporation is the highest rate of tax specified in section 11(b), and the applicable percentage for ECTI allocable to a non-corporate foreign partner is the highest rate of tax specified in section 1. Further, section 1446(d), as amended by the 1988 Act, provides that a foreign partner is entitled to a credit under section 33 for such partner's share of the 1446 tax, and, except as provided in regulations, such partner's share of the 1446 tax paid by the partnership is treated as distributed to such partner on the last day of the taxable year for which such tax was paid. The credit under section 33 is applied against the partner's U.S. tax liability for the taxable year in which the partner includes its allocable share of the partnership's effectively connected income.

Treasury and the IRS issued Rev. Proc. 89–31 to provide guidance to partnerships under section 1446, as amended by the 1988 Act. This revenue procedure made Rev. Proc. 88–21 obsolete. In general, Rev. Proc. 89–31 provides guidance concerning the requirement to pay a withholding tax, the determination of whether a partner is a foreign person, the calculation of partnership ECTI, the amount of the withholding tax, and the procedures for reporting and paying over the 1446 tax. The revenue procedure generally follows the regime set forth in section 6655 for estimated tax payments by corporations, and requires a partnership to annualize its ECTI and pay over the 1446 tax in quarterly installments. Further, the revenue procedure provides special rules for publicly traded partnerships and tiered partnership structures. A partnership subject to section 1446 must continue to comply with Rev. Proc. 89–31, as modified by Rev. Proc. 92–66 (discussed below), until the partnership's first taxable year beginning after the date these regulations are issued in final form.

Section 7811(i)(6) of the 1989 Act amended section 1446 in three respects. First, the amendment provides that, except as provided in regulations, a foreign partner's share of the 1446 tax paid by a partnership is treated as distributed to such partner on the earlier of the day on which such tax is paid by the partnership or the last day of the partnership's taxable year for which such tax is paid. Second, the amendment grants Treasury and the IRS regulatory authority to apply the addition to tax under section 6655 to a partnership as if it were a corporation. Third, the amendment clarifies that the applicable percentage for a foreign corporate partner is the highest rate of tax specified in section 11(b)(1). The changes made by the 1989 Act are effective for partnership taxable years beginning after December 31, 1987, as if originally included as part of the 1988 Act amendments.

In 1992, Treasury and the IRS issued Rev. Proc. 92–66, which modified Rev. Proc. 89–31 in three respects. First, Rev. Proc. 92–66 provides that the applicable percentage to be used by publicly traded partnerships in calculating the 1446 tax is the highest rate of tax imposed under section 1, which at that time was 31 percent. Second, the revenue procedure allows a partnership to seek a refund from the IRS in certain circumstances for amounts it has paid under section 1446. Third, the revenue procedure provides that a foreign partnership subject to withholding under section 1445(a) during a taxable year is allowed to credit the amount withheld under section 1445(a), to the extent such amount is allocable to foreign partners, against its liability to pay the 1446 tax for that year.

B. Structure of the Proposed Regulations

In general, the proposed regulations follow the approach in Rev. Proc. 89–31 for computing, paying over and reporting the 1446 tax. The proposed regulations are set forth in six sections. Section 1.1446–1 contains rules regarding a partnership's requirement to pay a withholding tax, and how a partnership should determine the status of its partners (*i.e.*, domestic or foreign, corporate or non-corporate). Section 1.1446–2 contains rules for calculating partnership ECTI allocable to each foreign partner. Section 1.1446–3 contains rules pertaining to a partnership's obligation to pay the 1446 tax on an installment basis, including guidance on calculating the 1446 tax, reporting and paying over the 1446 tax, and penalties for underpayment of the 1446 tax. Section 1.1446–4 contains special rules applicable to publicly traded partnerships. These rules generally implement a withholding regime based upon the distribution of effectively connected income to foreign partners. These regulations also permit publicly traded partnerships to elect to withhold and pay over the 1446 tax based upon the general rules set forth in §§ 1.1446–1 through 1.1446–3 (withholding based upon ECTI allocable under section 704 to foreign partners). Section 1.1446–5 contains rules applicable to tiered partnership structures, including rules for looking through certain upper-tier foreign partnerships to determine the 1446 tax obligation of a lower-tier partnership. Finally, § 1.1446–6 contains the proposed effective date of the regulations.

In addition to the proposed regulatory amendments under section 1446, these regulations also include proposed amendments to §§ 1.871–10, 1.1443–1, 1.1461–1 through 1.1461–3, 1.1462–1, 1.1463–1, 301.6109–1, and 301.6721–1, to coordinate the section 1446 withholding regime with existing regulations.

C. Determining the Status and Classification of Partners—§ 1.1441–1

Section 1446 applies only to partnerships with ECTI allocable under section 704 to one or more foreign partners. Section 1446(e) defines a foreign partner as any partner who is not a United States person. Section

7701(a)(30) defines a United States person to include a citizen or resident of the United States, a domestic partnership, a domestic corporation, any estate other than a foreign estate within the meaning of section 7701(a)(31), and any trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust. Section 1446 and the legislative history are silent as to how a partnership is to determine the domestic or foreign status of its partners.

Rev. Proc. 89–31 contains rules for determining whether a partner is a foreign partner for purposes of section 1446. Under the revenue procedure, a partnership may determine a partner's status by relying upon a certification of non-foreign status provided by the partner, or by relying on any other means. See Rev. Proc. 89–31, § 5.02 and § 5.03.

In order to reduce the paperwork burden imposed on taxpayers and avoid conflicting information, the proposed regulations reflect an approach different from the approach taken in Rev. Proc. 89–31 for determining whether a partner is a foreign partner. The proposed regulations generally require a partnership to comply with the paperwork requirements used under section 1441 to determine the status (domestic or foreign) and the tax classification (corporate or non-corporate) of its partners. Under the proposed regulations, a partnership should obtain either a Form W–8BEN, ''Certificate of Foreign Status of Beneficial Owner for U.S. Tax Withholding,'' Form W–8IMY, ''Certificate of Foreign Intermediary, Flow Through Entity, or Certain U.S. Branches for United States Tax Withholding,'' or Form W–9, ''Request for Taxpayer Identification Number and Certification,'' from each of its partners. Additionally, special rules are provided with respect to domestic and foreign trusts all or a portion of which are treated as owned by a grantor or another person under subpart E of subchapter J of the Code. The documentation requirement set forth in the proposed regulations will allow a partnership required to withhold under both section 1441 and section 1446 to receive one form instead of two from each of its partners, and thus will reduce the paperwork and recordkeeping burden imposed upon partners and partnerships. Further, the required documentation will also serve to establish a uniform basis for determining the foreign or non-foreign status of partners and to reduce the instances where a partnership receives inconsistent documentation.

In the absence of a valid Form W–8BEN, Form W–8IMY, or Form W–9 from a partner (or upon the receipt of a form that the partnership has actual knowledge or reason to know is incorrect or unreliable), the proposed regulations contain a presumption that the partner is a foreign person and that the partnership must pay 1446 tax on ECTI allocable to the partner. However, this presumption does not apply, and the partnership shall not be liable for 1446 tax with respect to a partner, to the extent the partnership relies on other means to ascertain the non-foreign status of a partner, and the partnership is correct in its determination that such partner is a U.S. person. This approach is similar to Rev. Proc. 89–31, which permitted partnerships to rely on other means to ascertain the non-foreign status of a partner. See Rev. Proc. 89–31, § 5.03. Under the proposed regulations, when the presumption of foreign status applies, the following rules apply for purposes of determining the applicable rate that will apply in computing the 1446 tax. If the partnership knows that the partner is an individual and not an entity, the partnership shall compute the 1446 tax with respect to such partner using the highest rate in section 1. If the partnership knows that the partner is an entity that is a corporation under § 301.7701–2(b)(8) (included on the per se list of entities under the entity classification regulations), the partnership shall treat the partner as a foreign corporation and compute the 1446 tax with respect to such partner using the highest rate in section 11(b)(1). In all other cases, including where the partnership cannot reliably determine the status of the partner, the proposed regulations presume that the partner is either a corporate or non-corporate partner, based upon whichever classification results in a higher 1446 tax being due. This presumption is necessary to prevent a partner from obtaining a more favorable withholding result than would have been achieved if the partner complied with the documentation requirements. The duration and validity of the forms required for purposes of section 1446 is intended to be consistent with the standards applicable when these forms are submitted in the context of sections 1441, 1442, and 3406. These forms and their instructions will be modified as necessary to facilitate their use under section 1446.

D. Determining a Foreign Partner's Allocable Share of Partnership ECTI—§ 1.1446–2

The proposed regulations contain rules for computing partnership ECTI allocable to foreign partners. Consistent with Rev. Proc. 89–31, the partnership determines its ECTI allocable to a foreign partner using an aggregate approach. The partnership first determines the effectively connected partnership items allocable to each of the partnership's foreign partners. Partnership ECTI allocable to all foreign partners then is computed by combining all of the foreign partners' allocable shares of partnership ECTI.

The proposed regulations also provide guidance concerning capital losses, suspended losses, and loss carryovers and carrybacks when determining a foreign partner's allocable share of partnership ECTI. The proposed regulations permit capital losses allocable to a foreign partner to offset such partner's allocable share of capital gains consistent with section 1211(a). Solely for purposes of section 1446, the proposed regulations do not permit the partnership to consider section 1211(b), which permits an individual to use capital losses in excess of capital gains to the extent of $3,000 per taxable year. Further, the proposed regulations do not permit the partnership to take into account in determining a foreign partner's allocable share of partnership ECTI any losses of a partner that are carried over or back or are suspended.

A number of issues arise under section 1446 where the partnership has cancellation of indebtedness income under section 61(a)(12), including difficulties arising because the exclusion of cancellation of indebtedness income under section 108 is applied at the partner level rather than at the partnership level. See section 108(d)(6). These proposed regulations do not specifically address the treatment of cancellation of indebtedness income of a partnership under section 1446. Comments are requested concerning the appropriate treatment under section 1446 of such income allocable to a foreign partner.

E. Calculating, Paying Over, and Reporting the 1446 Tax—§ 1.1446–3

Section 1446(f)(2) provides that the Secretary shall prescribe such regulations as may be necessary to carry out the purposes of section 1446, including regulations providing (1) that, for purposes of section 6655, the withholding tax imposed under section 1446 be treated as a tax imposed by section 11 and any partnership required

to pay such tax be treated as a corporation, and (2) appropriate adjustments in applying section 6655 with respect to such withholding. Section 6655 generally requires a corporation to make estimated tax payments throughout its taxable year, and determines an addition to tax for any underpayment of the required installments.

Rev. Proc. 89–31 generally requires a partnership, other than a publicly traded partnership, to determine its ECTI allocable to foreign partners, and, ultimately, its 1446 tax obligation, by annualizing its effectively connected items under one of the three options generally available to corporations under section 6655 when paying estimated taxes. As an alternative, Rev. Proc. 89–31 permits a partnership to determine its 1446 tax obligation based upon a safe harbor. Under both the safe harbor and the annualization methods, a partnership must pay the 1446 tax on an installment basis.

The proposed regulations adopt, with some modifications, the estimated tax payment rules set forth in section 6655, including the imposition of an addition to tax for an underpayment of the 1446 tax. Consistent with Rev. Proc. 89–31, the proposed regulations require a partnership to pay its 1446 tax obligation on an installment basis, and pay its 1446 tax either based upon annualizing its income or based upon a safe harbor. The proposed regulations broaden the approaches available in Rev. Proc. 89–31 in certain circumstances. Under the proposed regulations, a partnership that chooses to annualize its income may use certain methods in section 6655 that address the seasonality of income earned by a partnership. See section 6655(e). Further, the proposed regulations modify the safe harbor set forth in Rev. Proc. 89–31 so that a partnership does not need to have filed Form 1065, ''U.S. Return of Partnership Income,'' and Form 8804, ''Annual Return for Partnership Withholding Tax (Section 1446),'' at the time it makes an installment payment. Instead, it is sufficient if the partnership timely files these forms (taking into account extensions).

F. Special Rule for Tiered Trust or Estate Structures—§ 1.1446–3(d)(2)(iii)

Treasury and the IRS are concerned about the potential abuse of tiered trust structures to claim inappropriate refunds of the 1446 tax, to avoid reporting by a beneficiary of ECTI earned by a partnership, or to avoid section 1446 entirely. Existing provisions contemplate that entitlement to a credit or refund of any section 1446 withholding tax follows the liability for tax. Section 1446(d) provides that each foreign partner of a partnership shall be allowed a credit under section 33 for such partner's share of the 1446 tax paid by the partnership. A foreign partner's share of any 1446 tax paid by the partnership is treated as distributed to the partner by such partnership. Section 1462 provides that income on which any tax is required to be withheld at the source under chapter 3 of the Code, including section 1446, shall be included in the return of the recipient of such income, and any amount of tax so withheld may be credited against the amount of income tax as computed in such return. The regulations under section 1462 explain that an amount withheld on a payment to a fiduciary, partnership, or intermediary is deemed to have been paid by the taxpayer ultimately liable for the tax upon such income. See § 1.1462–1(b). Sections 702(b), 652(b), and 662(b) ensure that the character of income (*e.g.,* income that is effectively connected income) of a partnership allocated to a trust (whether domestic or foreign) is preserved in the hands of a beneficiary (see Rev. Rul. 85–60 (1985–1 C.B. 187)).

The proposed regulations include clarification of the regulations under section 1462 to coordinate with section 1446(d) to provide that a foreign trust's or estate's allocable share of ECTI is deemed to have been paid by the taxpayer ultimately liable for tax upon such income. In the case of a foreign grantor trust, the taxpayer ultimately liable for the tax upon such income is the grantor of such trust.

Further, § 1.1446–3 of the proposed regulations includes two rules and several examples pertaining to tiered trust or estate structures. The rules are intended to match the credit claimed under section 33 with the taxpayer that reports and pays tax on the ECTI upon which the credit is based. The first rule applies where a foreign trust or estate is a partner in a partnership required to pay the 1446 tax and the beneficiary of the foreign trust or estate is either another foreign trust (with a foreign person as a beneficiary of such trust) or a foreign person. In such a circumstance, the proposed regulations provide that the foreign trust or estate is only entitled to claim the portion of the credit under section 33 that corresponds to the portion of the associated effectively connected income on which it bears the tax liability.

The second rule addresses the use of a domestic trust. The second rule applies where a partnership knows or has reason to know that a foreign person that is the ultimate beneficial owner of the effectively connected income holds its interest in the partnership through a domestic trust, and such domestic trust was formed or availed of with a principal purpose of avoiding the 1446 tax. The use of a domestic trust in a tiered trust structure may have a principal purpose of avoiding the 1446 tax even though the tax avoidance purpose is outweighed by other purposes when taken together. Where applicable, this rule allows the IRS to impose the 1446 tax obligation on such partnership as if each domestic trust in the chain is a foreign trust.

G. Publicly Traded Partnerships—§ 1.1446–4

Section 1446(f)(1) provides that the Secretary shall prescribe regulations to apply section 1446 in the case of publicly traded partnerships. In this regard, the legislative history to section 1446 specifically notes that special rules may be necessary in identifying a publicly traded partnership's partners as U.S. or foreign. See H.R. Rep. No. 100–795, 100th Cong., 2d Sess. 291 (1988); S. Rep. No. 100–445, 100th Cong., 2d Sess. 305 (1988).

Rev. Proc. 89–31 provides special rules for publicly traded partnerships. Under Rev. Proc. 89–31, the term *publicly traded partnership* means a regularly traded partnership within the meaning of the regulations under section 1445(e)(1), but not a publicly traded partnership treated as a corporation under the general rules of section 7704(a). Generally, publicly traded partnerships with effectively connected income, gain or loss are required to withhold based upon distributions made to foreign partners. Rev. Proc. 92–66 modified the applicable percentage for withholding on distributions to the highest rate of tax imposed under section 1, and applied that percentage to both corporate and non-corporate partners.

Under Rev. Proc. 89–31, a publicly traded partnership generally determines the tax status of its partners by receiving either a certificate of non-foreign status, a Form W–8, or a Form W–9 from its partners, or by relying on other means. Further, nominees that hold interests in a publicly traded partnership on behalf of one or more foreign partners may be responsible for the 1446 tax liability for foreign partners under certain circumstances. Finally, Rev. Proc. 89–31 permits publicly traded partnerships to elect to apply the general rules that determine the 1446 tax based on a foreign partner's allocable share of partnership ECTI rather than on distributions to foreign partners. Under

Rev. Proc. 89–31, the publicly traded partnership makes this election by complying with the payment and reporting requirements of the general rules and attaching a statement to its annual return of withholding tax indicating that the election is being made.

The proposed regulations modify several of the rules for publicly traded partnerships set forth in Rev. Proc. 89–31. First, the proposed regulations define *publicly traded partnership* solely by reference to the definition in section 7704. Second, the proposed regulations provide that the documentation requirements and presumptions of § 1.1446–1 apply to publicly traded partnerships, thereby requiring such partnerships to obtain a Form W–8BEN, Form W–8IMY, or Form W–9 from each of their partners if they do not rely on other means to determine the status of their partners. Third, the proposed regulations provide that the applicable percentage for withholding on distributions is the rate applicable under section 1446(b).

Comments are requested as to whether the special rules applicable to publicly traded partnerships should be extended to other partnerships. Specifically, Treasury and the IRS are considering whether these special rules should apply to partnerships that make an election under section 775 of the Code or partnerships with a specified minimum number of partners.

H. Tiered Partnership Structures—§ 1.1446–5

Special concerns arise when a foreign partnership (upper-tier partnership) is a partner in a second partnership (lower-tier partnership) that is subject to section 1446. Section 1446(f) provides the Secretary with regulatory authority to prescribe rules necessary to carry out the purposes of the section. The legislative history to section 1446 notes that in the context of tiered partnership structures, ''rules may be necessary to prevent the imposition of more tax than will be properly due (for example, rules to prevent the tax from being imposed on more than one partnership and rules to determine the applicable percentages).'' H.R. Rep. No. 100–795, 100th Cong., 2d Sess. 291 (1988); S. Rep. No. 100–445, 100th Cong., 2d Sess. 305 (1988).

Rev. Proc. 89–31 employs an entity approach in computing the 1446 tax obligation of a partnership that has a foreign partnership as one of its partners. Under the entity approach, a lower-tier partnership must pay a 1446 tax at the highest rate in section 1 on an upper-tier foreign partnership's allocable share of ECTI, regardless of the composition of the upper-tier partnership. Rev. Proc. 89–31 provides the upper-tier partnership a credit for a portion of the 1446 tax paid by the lower-tier partnership to avoid multiple application of the 1446 tax. This approach may result in a partnership paying a 1446 tax that is greater in amount than would have been required if the partners of the upper-tier partnership had been direct partners of the lower-tier partnership, for example, where some of the partners of the upper-tier partnership are U.S. persons.

The proposed regulations modify the rules in Rev. Proc. 89–31 with respect to certain tiered partnership structures to address this situation. The proposed regulations provide that if a partner in a partnership that is required to pay the 1446 tax is a foreign partnership, it may submit a completed Form W–8IMY to the lower-tier partnership. If the upper-tier foreign partnership completes and submits Form W–8IMY to the lower-tier partnership, and passes along the Form W–8BEN, Form W–8IMY, or Form W–9 it received for some or all of its partners, as well as information describing how effectively connected items are allocated among its partners, the lower-tier partnership shall look through the upper-tier partnership to the partners of the upper-tier partnership (to the extent that it has received the appropriate documentation and allocation information and can reliably associate the allocation of its effectively connected items to the partners of the upper-tier partnership) to determine its 1446 tax obligation. To the extent the lower-tier partnership receives a valid Form W–8IMY from the upper-tier partnership but cannot reliably associate the upper-tier partnership's allocable share of effectively connected partnership items with a withholding certificate for each of the upper-tier partnership's partners, the lower-tier partnership shall withhold at the higher of the applicable percentages in section 1446(b).

Therefore, in appropriate circumstances, the lower-tier partnership may determine its 1446 tax obligation based on the status of its indirect partners. This approach generally is consistent with the paperwork requirements under section 1441 applicable to a nonwithholding foreign partnership and will ensure that the 1446 tax paid by the partnership more closely approximates the actual tax liability of the beneficial owner of the income in the case of a tiered partnership structure. An upper-tier foreign partnership with foreign partners remains obligated to file and report with respect to its 1446 tax obligation. Accordingly, the upper-tier partnership must comply with the general rules of section 1446, including requiring payment in installments, and reporting and passing along the credit under section 33 to its partners, which in these situations will also include the tax paid at the lower-tier partnership level.

Comments are requested on the general approach taken in these proposed regulations for situations involving two or more tiers of partnerships. Further, comments are requested as to the desirability and administrability of an alternative approach that allows a domestic upper-tier partnership with foreign partners to elect to pass information regarding its partners to the lower-tier partnership and have the lower-tier partnership pay the 1446 tax based upon the composition of the partners of the upper-tier partnership.

I. Withholding in Excess of Partner's Actual Tax Liability

Since the enactment of section 1446, Treasury and the IRS have received and considered several comments regarding the potential for section 1446 to require a partnership to pay a withholding tax in an amount that exceeds a foreign partner's actual tax liability for a taxable year. This situation may occur for several reasons, including that: (1) Section 1446 does not take into account a partner's losses from outside the partnership during the year, or a partner's loss carryovers; and (2) section 1446 requires withholding at the maximum statutory rates generally applicable to a foreign partner with effectively connected income. Section 1446 does not contain provisions for reducing or eliminating the general withholding obligation like the provisions contained in section 1445 (which impose a withholding tax in the case of the disposition of an interest in United States real property). See section 1445(c). Rev. Proc. 89–31 provides that section 1446 applies instead of section 1445(e)(1) where the two sections overlap, and, accordingly, partnerships owning U.S. real property are not permitted to reduce withholding on gains from the disposition of such property through the use of the procedures available under section 1445. See also § 8.01 of Rev. Proc. 2000–35 (2000–2 C.B. 211).

Treasury and the IRS considered comments regarding alternative approaches for adjusting the withholding tax obligation under section 1446 to more closely approximate a foreign partner's actual

U.S. tax liability. These proposed regulations contain provisions aimed at mitigating the potential for withholding in excess of the partner's actual tax liability (see *e.g.,* § 1.1446–5). These proposed regulations do not contain other provisions that have been suggested because, among other reasons, of concerns regarding the administrability of such approaches. Comments are requested with respect to approaches that would permit an adjustment to the amount of 1446 tax obligation that are consistent with the statute and legislative history and administrable by partnerships, partners and the IRS. In particular, comments are requested on whether the rules coordinating sections 1445 and 1446 should be modified to address these concerns.

J. Effective Date

These regulations are proposed to apply to partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

Effect on Other Documents

The following publications will be obsolete for partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**:
Rev. Proc. 89–31 (1989–1 C.B. 895)
Rev. Proc. 92–66 (1992–2 C.B. 428)

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. It also has been determined that section 533(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations. With respect to the collections of information contained in § 1.871–10, § 1.1446–1 (pertaining to domestic grantor trusts), and § 1.1446–3 (pertaining to foreign trusts), it is hereby certified that these collections of information will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that only limited small entities are impacted by these collections and the burden associated with such collections is .5 hours. With respect to the collections of information in §§ 1.1446–3 (pertaining to a partnership required to notify its foreign partners of an installment payment of 1446 tax paid on behalf of such partner) and 1.1446–4, it is hereby certified that these sections will not impose a significant economic impact on a substantial number of small entities. This certification is based upon the fact that while approximately 15,000 small entities will be impacted by these sections, the estimated annual burden associated with these sections is only .5 hours per respondent. Moreover, the information collection in § 1.1446–4 is voluntary. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet Site at *http://www.irs.gov/regs*. All comments will be available for public inspection and copying. The Treasury Department and IRS request comments on the clarity of the proposed regulations and how they may be made easier to understand.

A public hearing has been scheduled for December 4, 2003, beginning at 10 a.m. in the IRS Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. All visitors must come to the Constitution Avenue entrance and present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by November 13, 2003. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the schedule of speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is David J. Sotos, Office of the Associate Chief Counsel (International). However, other personnel from the Treasury Department and IRS participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements

26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and Recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

§ 1.1446–3 also issued under 26 U.S.C. 1446(f). * * *
§ 1.1446–4 also issued under 26 U.S.C. 1446(f). * * *

Par. 2. In § 1.871–10, paragraph (d)(3) is amended by adding a sentence at the end of that paragraph, and paragraph (e) is amended by revising the first sentence to read as follows:

§ 1.871–10 Election to treat real property income as effectively connected with U.S. business.

* * * * *

(d) * * *

(3) *Election by partnership.* * * * If the nonresident alien or foreign corporation makes an election, such person must provide the partnership a Form W–8BEN, ''Certificate of Foreign Status of Beneficial Owner for U.S. Withholding,'' and must indicate that the nonresident alien or foreign corporation has made the election under this section to treat real property income as effectively connected income.

(e) *Effective date.* This section shall apply for taxable years beginning after December 31, 1966, except the last sentence of paragraph (d)(3) shall apply to partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**. * * *

Par. 3. § 1.1443–1 is amended by:

1. Revising the first sentence of paragraph (a) and adding a sentence at the end of the paragraph.

2. Revising paragraph (c)(1).

The revision and additions read as follows:

§ 1.1443–1 Foreign tax-exempt organizations.

(a) *Income includible in computing unrelated business taxable income.* In the case of a foreign organization that is described in section 501(c), amounts paid or effectively connected taxable income allocable to the organization that are includible under section 512 in computing the organization's unrelated business taxable income are subject to withholding under §§ 1.1441–1, 1.1441–4, 1.1441–6, and 1.1446–1 through 1.1446–5, in the same manner as payments or allocations of effectively connected taxable income of the same amounts to any foreign person that is not a tax-exempt organization. * * * See also § 1.1446–3(c)(3).

* * * * *

(c) * * *

(1) *In general.* This section applies to payments made after December 31, 2000, except that the references in paragraph (a) of this section to effectively connected taxable income and withholding under section 1446 shall apply to partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

* * * * *

Par. 4. Sections 1.1446–0 through 1.1446–6 are added to read as follows.

§ 1.1446–0 Table of contents.

This section lists the captions contained in §§ 1.1446–1 through 1.1446–6.

§ 1.1446–1 Withholding tax on foreign partners' share of effectively connected taxable income.

(a) *In general.* If a domestic or foreign partnership has effectively connected taxable income as computed under § 1.1446–2 (ECTI), for any partnership tax year, and any portion of such taxable income is allocable under section 704 to a foreign partner, then the partnership must pay a withholding tax under section 1446 (1446 tax) at the time and in the manner set forth in this section and §§ 1.1446–2 through 1.1446–5.

(b) *Steps in determining 1446 tax obligation.* In general, a partnership determines its 1446 tax as follows. The partnership determines whether it has any foreign partners in accordance with

paragraph (c) of this section. If the partnership does not have any foreign partners (including any person presumed to be foreign under paragraph (c) of this section and any domestic trust treated as foreign under § 1.1446–3(d)) during its taxable year, it generally will not have a 1446 tax obligation. If the partnership has one or more foreign partners, it then determines under § 1.1446–2 whether it has ECTI any portion of which is allocable to one or more of the foreign partners. If the partnership has ECTI allocable to one or more of its foreign partners, the partnership computes its 1446 tax, pays over 1446 tax, and reports the amount paid in accordance with the rules in § 1.1446–3. For special rules applicable to publicly traded partnerships, see § 1.1446–4. For special rules applicable to tiered partnership structures, see § 1.1446–5.

(c) *Determining whether a partnership has a foreign partner*—(1) *In general.* Except as otherwise provided in § 1.1446–3, only a partnership that has at least one foreign partner during the partnership's taxable year can have a 1446 tax liability. The term foreign partner means any partner of the partnership who is not a U.S. person within the meaning of section 7701(a)(30). Thus, a partner of the partnership is a foreign partner if the partner is a nonresident alien individual, foreign partnership, foreign corporation, foreign estate or trust, as those terms are defined under section 7701 and the regulations thereunder, or a foreign government within the meaning of section 892 and the regulations thereunder. For purposes of this section, a partner that is treated as a U.S. person for all income tax purposes (by election or otherwise, see *e.g.,* sections 953(d), 1504(d)) will not be a foreign partner, provided the partner has provided the partnership a valid Form W–9, ''Request for Taxpayer Identification Number and Certification,'' or if the partnership uses other means to determine that the partner is not a foreign partner (see paragraph (c)(3) of this section). A partner that is treated as a U.S. person only for certain specified purposes is considered a foreign partner for purposes of section 1446, and a partnership must pay a withholding tax on the portion of ECTI allocable to that partner. For example, a partnership must generally pay 1446 tax on ECTI allocable to a foreign corporate partner that has made an election under section 897(i).

(2) *Forms W–8BEN, W–8IMY, and W–9*—(i) *In general.* Except as otherwise provided in this paragraph (c)(2) or paragraph (c)(3) of this section, a partnership must determine whether a partner is a foreign partner, and the partner's tax classification (*e.g.,* corporate or non-corporate), by obtaining from the partner a Form W–8BEN, ''Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding,'' Form W–8IMY, ''Certificate of Foreign Intermediary, Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding,'' or a Form W–9, as applicable. Specifically, a foreign partner that is a nonresident alien individual, a foreign estate or trust (other than a grantor trust described in this paragraph (c)(2)), a foreign corporation, or a foreign government should provide a valid Form W–8BEN. A partner that is a foreign partnership should provide a valid Form W–8IMY. A partner that is a U.S. person (other than a grantor trust described in this paragraph (c)(2)), including a domestic partnership, should provide a valid Form W–9. An entity that is disregarded as an entity separate from its owner under § 301.7701–3 of this chapter may not submit a Form W–8BEN, W–8IMY, or Form W–9. See §§ 301.7701–1 through 301.7701–3 of this chapter for determining the U.S. Federal tax classification of a partner. To the extent that a grantor or another person is treated as the owner of any portion of a trust under subpart E of subchapter J of the Internal Revenue Code, such trust shall not provide a Form W–8BEN or Form W–9 to the partnership, except to the extent that such trust is providing documentation on behalf of the grantor or other person treated as the owner of a portion of such trust as required by this paragraph (c)(2). Instead, if such trust is a foreign trust, the trust shall submit Form W–8IMY to the partnership identifying itself as a grantor trust and shall provide such documentation (*e.g.,* Forms W–8BEN, W–8IMY, or W–9) and information pertaining to its owner(s) to the partnership that permits the partnership to reliably associate (within the meaning of § 1.1441–1(b)(2)(vii)) such portion of the trust's allocable share of partnership ECTI with the grantor or other person that is the owner of such portion of the trust. If such trust is a domestic trust, the trust shall furnish the partnership a statement under penalty of perjury that the trust is, in whole or in part, a grantor trust and identifying that portion of the trust that is treated as owned by a grantor or another person under subpart E of subchapter J of the Internal Revenue Code. The trust shall also provide such documentation and information (*e.g.,* Forms W–8BEN, W–8IMY, or W–9) pertaining to its owner(s) to the partnership that permits the partnership to reliably associate such portion of the trust's allocable share of partnership ECTI with the grantor or other person that is the owner of such portion of the trust. With respect to nominees, only nominees described in § 1.1446–4(b)(3) holding interests in publicly traded partnerships subject to § 1.1446–4 may submit a Form W–9. See § 1.1446–4 for additional documentation that may be submitted by such a nominee. In all other cases where a nominee holds an interest in a partnership, the beneficial owner of the partnership interest, not the nominee, shall submit Form W–8BEN, Form W–8IMY, or Form W–9. A partnership that has obtained a valid Form W–8BEN, Form W–8IMY, or Form W–9 from a partner, nominee, or beneficial owner prior to the due date for paying any 1446 tax may rely on it to the extent provided in this paragraph (c)(2).

(ii) *Effect of Forms W–8BEN, W–8IMY, W–9, and Statement.* In general, for purposes of this section, a partnership may rely on a valid Form W–8BEN, Form W–8IMY, Form W–9, statement described in § 1.1446–4(e)(1), or statement described in this paragraph (c)(2) from a partner, nominee, beneficial owner, or grantor trust to determine whether that person, beneficial owner, or the owner of a grantor trust, is a domestic or foreign partner or a nominee, and if such person is a foreign partner, to determine whether or not such person is a corporation for U.S. tax purposes. To the extent a partnership receives a Form W–8IMY from a foreign grantor trust or a statement described in this paragraph (c)(2) from a domestic grantor trust, but does not receive a Form W–8BEN, Form W–8IMY, or Form W–9 identifying such grantor or other person, the rules of paragraph (c)(3) of this section shall apply. Further, a partnership may not rely on a Form W–8BEN, Form W–8IMY, Form W–9, or statement described in § 1.1446–4(e)(1) or this paragraph (c)(2), and such form or statement is therefore not valid, if the partnership has actual knowledge or has reason to know that any information on the withholding certificate or statement is incorrect or unreliable and, if based on such knowledge or reason to know, it should pay a 1446 tax in an amount greater than would be the case if it relied on the information or certifications. A partnership has reason to know that information on a withholding certificate or statement is incorrect or unreliable if its knowledge

of relevant facts or statements contained on the form or other documentation is such that a reasonably prudent person in the position of the withholding agent would question the claims made. See §§ 1.1441–1(e)(4)(viii) and 1.1441–7(b)(1) and (2). If the partnership does not know or have reason to know that a Form W–8BEN, Form W–8IMY, Form W–9, or statement received from a partner, nominee, beneficial owner, or grantor trust contains incorrect or unreliable information, but it subsequently determines that it does contain incorrect or unreliable information, and, based on such knowledge the partnership should pay 1446 tax in an amount greater than would be the case if it relied on the information or certification, the partnership will not be subject to penalties for its failure to pay the 1446 tax in reliance on such form or statement for any installment payment date prior to the date that the determination is made. See §§ 1.1446–1(c)(4) and 1.1446–3 concerning penalties for failure to pay the withholding tax when a partnership knows or has reason to know that the form or statement is incorrect or unreliable.

(iii) *Requirements for certificates to be valid.* Except as otherwise provided in this paragraph (c), for purposes of this section, the validity of a Form W–9 shall be determined under section 3406 and § 31.3406(h)–3(e) of this chapter which establish when such form may be reasonably relied upon. A Form W–8BEN, or Form W–8IMY is only valid for purposes of this section if its validity period has not expired, the partner submitting the form has signed it under penalties of perjury, and it contains all the required information.

(A) *When period of validity expires.* For purposes of this section, a Form W–8BEN or W–8IMY submitted by a partner shall be valid until the end of the period of validity determined for such form under § 1.1441–1(e). With respect to a foreign partnership submitting Form W–8IMY, the period of validity of such form shall be determined under § 1.1441–1(e) as if such foreign partnership submitted the form required of a nonwithholding foreign partnership. See § 1.1441–1(e)(4)(ii).

(B) *Required information for Forms W–8BEN and W–8IMY.* Forms W–8BEN and W–8IMY submitted under this section must contain the partner's name, permanent address and Taxpayer Identification Number (TIN), the country under the laws of which the partner is formed, incorporated or governed (if the person is not an individual), the classification of the partner for U.S. federal tax purposes (*e.g.*, partnership, corporation), and any other information required to be submitted by the forms or instructions to Form W–8BEN or Form W–8IMY, as applicable.

(iv) *Partner must provide new withholding certificate when there is a change in circumstances.* The principles of § 1.1441–1(e)(4)(ii)(D) shall apply when a change in circumstances has occurred (including situations where the status of a U.S. person changes) that requires a partner to provide a new withholding certificate.

(v) *Partnership must retain withholding certificates.* A partnership or nominee who has responsibility for paying the withholding tax under this section or § 1.1446–4, must retain each withholding certificate and other documentation received from its direct and indirect partners (including nominees) for as long as it may be relevant to the determination of the withholding agent's tax liability under section 1461 and the regulations thereunder.

(3) *Presumption of foreign status in absence of valid Form W–8BEN, Form W–8IMY, Form W–9, or statement.* Except as otherwise provided in this paragraph (c)(3), a partnership that does not receive a valid Form W–8BEN, Form W–8IMY, Form W–9, statement described in § 1.1446–4(e)(1), or statement required by paragraph (c)(2) of this section from a partner, nominee, beneficial owner, or grantor trust, or a partnership that receives a withholding certificate or statement but has actual knowledge or reason to know that the information on the certificate or statement is incorrect or unreliable, must presume that the partner is a foreign person. If the partnership knows that the partner is an individual and not an entity, the partnership shall treat the partner as a nonresident alien individual. If the partnership knows that the partner is an entity, the partnership shall treat the partner as a corporation if the entity is a corporation as defined in § 301.7701–2(b)(8) of this chapter. In all other cases, the partnership shall treat the partner as either a nonresident alien individual or a foreign corporation, whichever classification results in a higher 1446 tax being due, and shall pay the 1446 tax in accordance with this presumption. The presumption set forth in this paragraph (c)(3) that a partner is a foreign person (either because a Form W–9 was not furnished by such partner or the partnership determines that such form is incorrect or unreliable) shall not apply to the extent that the partnership relies on other means to ascertain the non-foreign status of a partner and the partnership is correct in its determination that such partner is a U.S. person. A partnership is in no event required to rely upon other means to determine the non-foreign status of a partner and may demand that a partner furnish a Form W–9. If a certification is not provided in such circumstances, the partnership may presume that the partner is a foreign partner, and for purposes of sections 1461 through 1463, will be considered to have been required to pay 1446 tax on such partner's allocable share of partnership ECTI.

(4) *Consequences when partnership knows or has reason to know that Form W–8BEN, Form W–8IMY, or Form W–9 is incorrect or unreliable and does not withhold.* If a partnership knows or has reason to know that a Form W–8BEN, Form W–8IMY, Form W–9, statement described in § 1.1446–4(e)(1), or statement required by paragraph (c)(2) of this section submitted by a partner, nominee, beneficial owner, or grantor trust contains incorrect or unreliable information (either because the certificate or statement when given to the partnership contained incorrect information or because there has been a change in facts that makes information on the certificate or statement incorrect), and the partnership pays less than the full amount of withholding tax due on ECTI allocable to that partner, the partnership shall be fully liable under section 1461 and § 1.1461–3 (§ 1.1461–1 for publicly traded partnerships subject to § 1.1446–4), § 1.1446–3, and for all applicable penalties and interest, for any failure to pay the 1446 tax for the period during which the partnership knew or had reason to know that the certificate contained incorrect or unreliable information and for all subsequent installment periods. If a partner, nominee, beneficial owner, or grantor trust, submits a new valid Form W–8BEN, Form W–8IMY, Form W–9, or statement, as applicable, the partnership may rely on that form for paying installments of 1446 tax beginning with the installment period during which such form is received.

§ 1.1446–2 Determining a partnership's effectively connected taxable income allocable to foreign partners under section 704.

(a) *In general.* A partnership's effectively connected taxable income (ECTI) is generally the partnership's taxable income as computed under section 703, with adjustments as provided in section 1446(c) and this section, and computed with

consideration of only those partnership items which are effectively connected (or treated as effectively connected) with the conduct of a trade or business in the United States. For purposes of determining the section 1446 withholding tax (1446 tax) under § 1.1446–3, partnership ECTI allocable under section 704 to foreign partners is the sum of the allocable shares of ECTI of each of the partnership's foreign partners as determined under paragraph (b) of this section. The calculation of partnership ECTI allocable to foreign partners as set forth in paragraph (b) of this section, and the determination of the partnership's withholding tax obligation, is a partnership-level computation solely for purposes of determining the 1446 tax. Therefore, any deduction that is not taken into account in calculating a partner's allocable share of partnership ECTI (*e.g.*, percentage depletion), but which is a deduction that under U.S. tax law the foreign partner is otherwise entitled to claim, can still be claimed by the foreign partner when computing its U.S. tax liability and filing its U.S. income tax return, subject to any restriction or limitation that otherwise may apply.

(b) *Computation*—(1) *In general.* A foreign partner's allocable share of partnership ECTI for the partnership's taxable year that is allocable under section 704 to a particular foreign partner is equal to that foreign partner's distributive share of partnership gross income and gain for the partnership's taxable year that is effectively connected and properly allocable to the partner under section 704 and the regulations thereunder, reduced by the foreign partner's distributive share of partnership deductions for the partnership taxable year that are connected with such income under section 873 or 882(c) and properly allocable to the partner under section 704 and the regulations thereunder, in each case, after application of the rules of this section. For these purposes, a foreign partner's distributive share of effectively connected gross income and gain and the deductions connected with such income shall be computed by considering allocations that are respected under the rules of section 704 and § 1.704–1(b)(1), including special allocations in the partnership agreement (as defined in § 1.704–1(b)(2)(ii)(h)), and adjustments to the basis of partnership property described in section 743 pursuant to an election by the partnership under section 754 (see § 1.743–1(j)). The character of effectively connected partnership items (capital versus ordinary) shall be separately considered only to the extent set forth in paragraph (b)(3)(v) of this section.

(2) *Income and gain rules.* For purposes of computing a foreign partner's allocable share of partnership ECTI under this paragraph (b), the following rules with respect to partnership income and gain shall apply.

(i) *Application of the principles of section 864.* The determination of whether a partnership's items of gross income are effectively connected shall be made by applying the principles of section 864 and the regulations thereunder.

(ii) *Income treated as effectively connected.* A partnership's items of gross income that are effectively connected includes any income that is treated as effectively connected income, including partnership income subject to a partner's election under section 871(d) or section 882(d), any partnership income treated as effectively connected with the conduct of a U.S. trade or business pursuant to section 897, and any other items of partnership income treated as effectively connected under another provision of the Code, without regard to whether those amounts are taxable to the partner.

(iii) *Exempt income.* A foreign partner's allocable share of partnership ECTI does not include income or gain exempt from U.S. tax by reason of a provision of the Internal Revenue Code. A foreign partner's allocable share of partnership ECTI also does not include income or gain exempt from U.S. tax by operation of any U.S. income tax treaty or reciprocal agreement. In the case of income excluded by reason of a treaty provision, such income must be derived by a resident of an applicable treaty jurisdiction, the resident must be the beneficial owner of the item, and all other requirements for benefits under the treaty must be satisfied. The partnership must have received from the partner a valid withholding certificate, that is Form W–8BEN or Form W–8IMY (see § 1.1446–1(c)(2)(iii) regarding when a Form W–8BEN or Form W–8IMY is valid for purposes of this section), containing the information necessary to support the claim for treaty benefits required in the forms and instructions to those forms. In addition, for purposes of this section, the withholding certificate must contain the beneficial owner's taxpayer identification number.

(3) *Deduction and losses.* For purposes of computing a foreign partner's allocable share of partnership ECTI under this paragraph (b), the following rules with respect to deductions and losses shall apply.

(i) *Oil and gas interests.* The deduction for depletion with respect to oil and gas wells shall be allowed, but the amount of such deduction shall be determined without regard to sections 613 and 613A.

(ii) *Charitable contributions.* The deduction for charitable contributions provided in section 170 shall not be allowed.

(iii) *Net operating losses and other suspended or carried losses.* The net operating loss deduction of any foreign partner provided in section 172 shall not be taken into account. Further, the partnership shall not take into account any suspended losses (*e.g.*, losses in excess of a partner's basis in the partnership, see section 704(d)) or any capital loss carrybacks or carryovers available to a foreign partner.

(iv) *Interest deductions.* The rules of this paragraph (b)(3)(iv) shall apply for purposes of determining the amount of interest expense that is allocable to income which is (or is treated as) effectively connected with the conduct of a trade or business for purposes of calculating the foreign partner's allocable share of partnership ECTI. In the case of a non-corporate foreign partner, the rules of § 1.861–9T(e)(7) shall apply. In the case of a corporate foreign partner, the rules of § 1.882–5 shall apply by treating the partnership as a foreign corporation and using the partner's pro-rata share of the partnership's assets and liabilities for these purposes. For these purposes, the rules governing elections under § 1.882–5(a)(7) shall be made at the partnership level.

(v) *Limitation on capital losses.* Losses from the sale or exchange of capital assets allocable under section 704 to a partner shall be allowed only to the extent of gains from the sale or exchange of capital assets allocable under section 704 to such partner.

(vi) *Other deductions.* No deduction shall be allowed for personal exemptions provided in section 151 or the additional itemized deductions for individuals provided in part VII of subchapter B of the Internal Revenue Code (section 211 and following).

(vii) *Limitations on deductions.* Except as provided in paragraph (b)(3) or (4) of this section, any limitations on losses or deductions that apply at the partner level when determining ECTI allocable to a foreign partner shall not be taken into account.

(4) *Other rules*—(i) *Exclusion of items allocated to U.S. partners.* In computing ECTI allocable to a foreign partner, the partnership shall not take into account any item of income, gain, loss, or deduction to the extent allocable to any

partner that is not a foreign partner, as that term is defined in § 1.1446–1(c) of this section.

(ii) *Partnership credits.* See § 1.1446–3(a) providing that the 1446 tax is computed without regard to a partner's distrubutive share of the partnership's tax credits.

(5) *Examples.* The following examples illustrate the application of this section:

Example 1. Limitation on capital losses. PRS partnership has two equal partners, A and B. A is a nonresident alien individual and B is a U.S. citizen. A provides PRS with a valid Form W–8BEN, and B provides PRS with a valid Form W–9. PRS has the following annualized tax items for the relevant installment period, all of which are effectively connected with its U.S. trade or business and are allocated equally between A and B: $100 of long-term capital gain, $400 of long-term capital loss, $300 of ordinary income, and $100 of ordinary deductions. Assume that these allocations are respected under section 704(b) and the regulations thereunder. Accordingly, A's allocable share of PRS's effectively connected items includes $50 of long-term capital gain, $200 of long-term capital loss, $150 of ordinary income, and $50 of ordinary deductions. In determining A's allocable share of partnership ECTI, the amount of the long-term capital loss that may be taken into account pursuant to paragraph (b)(3)(v) of this section is limited to A's allocable share of gain from the sale or exchange of capital assets. The amount of partnership ECTI allocable under section 704 to A is $100 ($150 of ordinary income less $50 of ordinary deductions, plus $50 of capital gains less $50 of capital loss).

Example 2. Limitation on capital losses—special allocations. PRS partnership has two equal partners, A and B. A and B are both nonresident alien individuals. A and B each provide PRS with a valid Form W–8BEN. PRS has the following annualized tax items for the relevant installment period, all of which are effectively connected with its U.S. trade or business: $200 of long-term capital gain, $200 of long-term capital loss, and $400 of ordinary income. A and B have equal shares in the ordinary income, however, pursuant to the partnership agreement, capital gains and losses are subject to special allocations. The long-term capital gain is allocable to A, and the long-term capital loss is allocable to B. It is assumed that all of the partnership's allocations are respected under section 704(b) and the regulations thereunder. Pursuant to paragraph (b)(3)(v) of this section, A's allocable share of partnership ECTI is $400 ($200 of ordinary income plus $200 of long-term capital gain), and B's allocable share of partnership ECTI is $200 ($200 of ordinary income).

Example 3. Withholding tax obligation where partner has net operating losses. PRS partnership has two equal partners, FC, a foreign corporation, and DC, a domestic corporation. FC and DC provide a valid Form W–8BEN and Form W–9, respectively, to PRS. Both FC and PRS are on a calendar taxable year. PRS is engaged in the conduct of a trade or business in the United States and for its first installment period during its taxable year has $100 of annualized ECTI that is allocable to FC. As of the beginning of the taxable year, FC had an unused effectively connected net operating loss carryover in the amount of $300. The net operating loss carryover is not taken into account in determining PRS's withholding tax liability for ECTI allocable under section 704 to FC. PRS must pay 1446 tax with respect to the $100 of ECTI allocable to FC.

§ 1.1446–3 Time and manner of calculating and paying over the 1446 tax.

(a) *In general*—(1) *Calculating 1446 tax.* This section provides rules for calculating, reporting, and paying over the section 1446 withholding tax (1446 tax). A partnership's 1446 tax is equal to the amount determined under this section and shall be paid in installments during the partnership's taxable year (see paragraph (d)(1) of this section for installment payment due dates), with any remaining tax due paid with the partnership's annual return required to be filed pursuant to paragraph (d) of this section. For these purposes, a partnership shall not take into account either a partner's liability for any other tax imposed under any other provision of the Internal Revenue Code (*e.g.*, section 55 or 884) or a partner's distributive share of the partnership's tax credits when determining the amount of the partnership's 1446 tax.

(2) *Applicable percentage.* In the case of a foreign partner that is a corporation, the applicable percentage is the highest rate of tax specified in section 11(b)(1) for such taxable year. Except to the extent provided in § 1.1446–5, in the case of a foreign partner that is not taxable as a corporation (*e.g.*, partnership, individual, trust or estate), the applicable percentage is the highest rate of tax specified in section 1.

(b) *Installment payments*—(1) *In general.* Except as provided in § 1.1446–4 for certain publicly traded partnerships, a partnership must pay its 1446 tax by making installment payments of the 1446 tax based on the amount of partnership ECTI allocable under section 704 to its foreign partners, without regard to whether the partnership makes any distributions to its partners during the partnership's taxable year. The amount of the installment payments are determined in accordance with this paragraph (b), and the tax must be paid at the times set forth in paragraph (d) of this section. Subject to paragraph (b)(3) of this section, in computing its first installment of 1446 tax for a taxable year, a partnership must choose whether it will pay its 1446 tax for the entire taxable year by using the safe harbor set forth in paragraph (b)(3) of this section, or by using one of several annualization methods available under paragraph (b)(2)(ii) of this section for computing partnership ECTI allocable to foreign partners. In the case of any underpayment of an installment payment of 1446 tax by a partnership, the partnership shall be subject to an addition to tax equal to the amount determined under section 6655, as modified by this section, as if such partnership were a domestic corporation, as well as any other applicable interest and penalties. See § 1.1446–3(f). Section 6425 (permitting an adjustment for an overpayment of estimated tax by a corporation) shall not apply to a partnership with respect to the payment of its 1446 tax.

(2) *Calculation*—(i) *General application of the principles of section 6655.* Installment payments of 1446 tax required during the partnership's taxable year are based upon partnership ECTI for the portion of the partnership taxable year to which they relate, and, except as set forth in this paragraph (b)(2) or paragraph (b)(3) of this section, shall be calculated using the principles of section 6655. Under the principles of section 6655, the partnership's effectively connected items are annualized to determine each foreign partner's allocable share of partnership ECTI under § 1.1446–2. Each foreign partner's allocable share of partnership ECTI is then multiplied by the applicable percentage for each foreign partner. This computation will yield an annualized 1446 tax with respect to such partner. The installment of 1446 tax due with respect to a foreign partner's allocable share of partnership ECTI equals the excess of the section 6655(e)(2)(B)(ii) percentage of the annualized 1446 tax for that partner (or, if applicable, the adjusted seasonal amount) for the relevant installment period, over the aggregate of any amounts paid under section 1446 with respect to that partner in prior installments during the partnership's taxable year.

(ii) *Annualization methods.* A partnership that chooses to annualize its income for the taxable year shall use one of the annualization methods set forth in section 6655(e) and the regulations thereunder, and as described in the forms and instructions for Form 8804, ''Annual Return for Partnership Withholding Tax (Section 1446),'' Form 8805, ''Foreign Partner's Information Statement of Section 1446 Withholding Tax,'' and Form 8813, ''Partnership Withholding Tax Payment Voucher.''

(iii) *Partner's estimated tax payments.* In computing its installment payments of 1446 tax, a partnership may not take

into account a partner's estimated tax payments.

(iv) *Partner whose interest terminates during the partnership's taxable year.* With respect to a partner whose interest in the partnership terminates prior to the end of the period for which the partnership is making an installment payment, the partnership shall take into account the income that is allocable to the partner for the portion of the partnership taxable year that the person was a partner.

(v) *Exceptions and modifications to the application of the principles under section 6655.* To the extent not otherwise modified in §§ 1.1446–1 through 1.1446–6, or inconsistent with those rules, the principles of section 6655 apply to the calculation of the installment payments of 1446 tax made by a partnership, except that:

(A) *Inapplicability of special rules for large corporations.* The principles of section 6655(d)(2), concerning large corporations (as defined in section 6655(g)(2)), shall not apply.

(B) *Inapplicability of special rules regarding early refunds.* The principles of section 6655(h), applicable to amounts excessively credited or refunded under section 6425, shall not apply. See paragraph (b)(1) of this section providing that section 6425 shall not apply for purposes of the 1446 tax.

(C) *Period of underpayment.* The period of the underpayment set forth in section 6655(b)(2) shall end on the earlier of the 15th day of the 4th month following the close of the partnership's taxable year (or, in the case of a partnership described in § 1.6081–5(a)(1) of this chapter, the 15th day of the 6th month following the close of the partnership's taxable year), or with respect to any portion of the underpayment, the date on which such portion is paid.

(D) *Other taxes.* Section 6655 shall be applied without regard to any references to alternative minimum taxable income and modified alternative minimum taxable income.

(E) *1446 tax treated as tax under section 11.* The principles of section 6655(g)(1) shall be applied to treat the 1446 tax as a tax imposed by section 11.

(F) *Prior year tax safe harbor.* The safe harbor set forth in section 6655(d)(1)(B)(ii) shall not apply and instead the safe harbor set forth in paragraph (b)(3) of this section applies.

(3) *1446 tax safe harbor*—(i) *In general.* The addition to tax under section 6655 shall not apply to a partnership with respect to a current installment of 1446 tax if—

(A) The average of the amount of the current installment and prior installments during the taxable year is at least 25 percent of the total 1446 tax that would be payable on the amount of the partnership's ECTI allocable under section 704 to foreign partners for the prior taxable year;

(B) The prior taxable year consisted of twelve months;

(C) The partnership timely files (including extensions) an information return under section 6031 for the prior year; and

(D) The amount of ECTI for the prior taxable year is not less than 50 percent of the ECTI shown on the annual return of section 1446 withholding tax that is (or will be) timely filed for the current year.

(ii) *Permission to change to standard annualization method.* Except as otherwise provided in this paragraph (b)(3), if a partnership chooses to pay its 1446 tax for the first installment period based upon the safe harbor method set forth in this paragraph (b)(3), the partnership must use the safe harbor method for each installment payment made during the partnership's taxable year. Notwithstanding the foregoing, if a partnership paying over 1446 tax during the taxable year pursuant to this paragraph (b)(3) determines during an installment period (based upon the standard option annualization method set forth in section 6655(e) and the regulations thereunder, as modified by the forms and instructions to Forms 8804, 8805, and 8813) that it will not qualify for the safe harbor in this paragraph (b)(3) because the prior year's ECTI will not meet the 50-percent threshold in paragraph (b)(3)(i)(D) of this section, then the partnership is permitted, without being subject to the addition to tax under section 6655, to pay over its 1446 tax for the period in which such determination is made, and all subsequent installment periods during the taxable year, using the standard option annualization method. A change pursuant to this paragraph shall be disclosed in a statement attached to the Form 8804 the partnership files for the taxable year and shall include information to allow the Service to determine whether the change was appropriate.

(c) *Coordination with other withholding rules*—(1) *Fixed or determinable, annual or periodical income.* Fixed or determinable, annual or periodical income subject to tax under section 871(a) or section 881 is not subject to withholding under section 1446, and such income is independently subject to the withholding requirements of sections 1441 and 1442 and the regulations thereunder.

(2) *Real property gains*—(i) *Domestic partnerships.* A domestic partnership that is otherwise subject to the withholding requirements of sections 1445 and 1446 will be subject to the payment and reporting requirements of section 1446 only and not section 1445(e)(1) and the regulations thereunder, with respect to partnership gain from the disposition of a U.S. real property interest (as defined in section 897(c)), provided that the partnership complies fully with the requirements under section 1446 and the regulations thereunder, including any reporting obligations, with respect to dispositions of U.S. real property interests. A partnership that has complied with such requirements will be deemed to satisfy the withholding requirements of section 1445 and the regulations thereunder. In the event that amounts are withheld under section 1445(a) at the time of the disposition of a U.S. real property interest, such amounts may be credited against the section 1446 tax.

(ii) *Foreign partnerships.* A foreign partnership that is subject to withholding under section 1445(a) during its taxable year may credit the amount withheld under section 1445(a) against its section 1446 tax liability for that taxable year only to the extent such gain is allocable to foreign partners.

(3) *Coordination with section 1443.* A partnership that has ECTI allocable under section 704 to a foreign organization described in section 1443(a) shall be required to withhold under this section.

(d) *Reporting and crediting the 1446 tax*—(1) *Reporting 1446 tax.* This paragraph (d) sets forth the rules for reporting and crediting the 1446 tax paid by a partnership. To the extent that 1446 tax is paid on behalf of a domestic trust (including a grantor or other person treated as an owner of a portion of such trust) or a grantor or other person treated as the owner of a portion of a foreign trust, the rules of this paragraph (d) applicable to a foreign trust or its beneficiaries shall be applied to such domestic or foreign trust and its beneficiaries or owners, as applicable, so that appropriate credit for the 1446 tax may be claimed by the trust, beneficiary, grantor, or other person.

(i) *Reporting of installment tax payments and notification to partners of installment tax payments.* Each partnership required to make an installment payment of 1446 tax must file Form 8813, ''Partnership Withholding Tax Payment Voucher (Section 1446),'' in accordance with the instructions of that form. When making a payment of 1446 tax, a partnership must notify each foreign partner of the

1446 tax paid on its behalf. A foreign partner generally may credit a 1446 tax paid by the partnership on the partner's behalf against the partner's estimated tax that the partner must pay during the partner's own taxable year. No particular form is required for a partnership's notification to a foreign partner, but each notification must include the partnership's name, the partnership's Taxpayer Identification Number (TIN), the partnership's address, the partner's name, the partner's TIN, the partner's address, the annualized ECTI estimated to be allocated to the foreign partner, and the amounts of tax paid on behalf of the partner for the current and prior installment periods during the partnership's taxable year.

(ii) *Payment due dates.* The 1446 tax is calculated based on partnership ECTI allocable under section 704 to foreign partners during the partnership's taxable year, as determined under section 706. Payments of the 1446 tax generally must be made during the partnership's taxable year in which such income is derived. A partnership must pay to the Internal Revenue Service a portion of its estimated annual 1446 tax in installments on or before the 15th day of the fourth, sixth, ninth, and twelfth months of the partnership's taxable year as provided in section 6655. Any additional amount determined to be due is to be paid with the filing of the annual return of tax required under this section and clearly designated as for the prior taxable year. Form 8813 should not be submitted for a payment made under the preceding sentence.

(iii) *Annual return and notification to partners.* Every partnership (except a publicly traded partnership that has not elected to apply the general withholding tax rules under section 1446) that has effectively connected gross income for the partnership's taxable year allocable under section 704 to one or more of its foreign partners (or is treated as having paid 1446 tax under § 1.1446–5(a)), must file Form 8804, ''Annual Return for Partnership Withholding Tax (Section 1446).'' Additionally, every partnership that is required to file Form 8804 also must file Form 8805, ''Foreign Partner's Information Statement of Section 1446 Withholding Tax,'' and furnish this form to the Internal Revenue Service and to each of its partners with respect to which the 1446 tax was paid. Forms 8804 and 8805 are separate from Form 1065, ''U.S. Return of Partnership Income,'' and the attachments thereto, and are not to be filed as part of the partnership's Form 1065. A partnership must generally file Forms 8804 and 8805 on or before the due date for filing the partnership's Form 1065. See § 1.6031(a)-1(c) for rules concerning the due date of a partnership's Form 1065. However, with respect to partnerships described in § 1.6081–5(a)(1), Forms 8804 and 8805 are not due until the 15th day of the sixth month following the close of the partnership's taxable year. Any additional tax owed under section 1446 for the prior taxable year of the partnership must be paid to the Internal Revenue Service with the Form 8804.

(iv) *Information provided to beneficiaries of foreign trusts and estates.* A foreign trust or estate that is a partner in a partnership subject to withholding under section 1446 shall be provided Form 8805 by the partnership. The foreign trust or estate must provide to each of its beneficiaries a copy of the Form 8805 furnished by the partnership. In addition, the foreign trust or estate must provide a statement for each of its beneficiaries to inform each beneficiary of the amount of the credit that may be claimed under section 33 (as determined under this section) for the 1446 tax paid by the partnership. Until an official IRS form is available, the statement from a foreign trust or estate that is described in this paragraph (d)(1)(iv) shall contain the following information—

(A) Name, address, and TIN of the foreign trust or estate;

(B) Name, address, and TIN of the partnership;

(C) The amount of the partnership's ECTI allocated to the foreign trust or estate for the partnership taxable year (as shown on the Form 8805 provided to the trust or estate);

(D) The amount of 1446 tax paid by the partnership on behalf of the foreign trust or estate;

(E) Name, address, and TIN of the beneficiary of the foreign trust or estate;

(F) The amount of the partnership's ECTI allocated to the trust or estate for purposes of section 1446 that is to be included in the beneficiary's gross income; and

(G) The amount of 1446 tax paid by the partnership on behalf of the foreign trust or estate that the beneficiary is entitled to claim on its return as a credit under section 33.

(v) *Attachments required of foreign trusts and estates.* The statement furnished to each foreign beneficiary under this paragraph (d)(1) must also be attached to the foreign trust or estate's U.S. Federal income tax return filed for the taxable year including the installment period to which the statement relates.

(vi) *Attachments required of beneficiaries of foreign trusts and estates.* The beneficiary of the foreign trust or estate must attach the statement provided by the trust or estate, along with a copy of the Form 8805 furnished by the partnership to such trust or estate, to its U.S. income tax return for the year in which it claims a credit for the 1446 tax. See § 1.1446–3(d)(2)(ii) for additional rules regarding a partner or beneficial owner claiming a credit for 1446 tax.

(vii) *Information provided to beneficiaries of foreign trusts and estates that are partners in certain publicly traded partnerships.* A statement similar to the statement required by paragraph (d)(1)(iv) of this section shall be provided by trusts or estates that hold interests in publicly traded partnerships subject to § 1.1446–4.

(2) *Crediting 1446 tax against a partner's U.S. tax liability*—(i) *In general.* A partnership's payment of 1446 tax on the portion of ECTI allocable to a foreign partner relates to the partner's U.S. income tax liability for the partner's taxable year in which the partner is subject to U.S. tax on that income. Subject to paragraphs (d)(2)(ii) and (iii) of this section, a partner may claim as a credit under section 33 the 1446 tax paid by the partnership with respect to ECTI allocable to that partner. The partner may not claim an early refund of these amounts under the estimated tax rules.

(ii) *Substantiation for purposes of claiming the credit under section 33.* A partner may credit the amount paid under section 1446 with respect to such partner against its U.S. income tax liability only if it attaches proof of payment to its U.S. income tax return for the partner's taxable year in which the items comprising such partner's allocable share of partnership ECTI are included in the partner's income. Except as provided in the next sentence, proof of payment consists of a copy of the Form 8805 the partnership provides to the partner (or in the case of a beneficiary of a foreign trust or estate, the statement required under paragraph (d)(1)(iv) of this section to be provided by such trust or estate and the related Form 8805 furnished to such trust or estate), but only if the name and TIN on the Form 8805 (or the statement provided by a foreign trust or estate) match the name and TIN on the partner's U.S. tax return, and such form (or statement) identifies the partner (or beneficiary) as the person entitled to the credit under section 33. In the case of a partner of a publicly traded partnership that is subject to withholding on distributions under § 1.1446–4, proof of payment consists of

a copy of the Form 1042–S, ''Foreign Person's U.S. Source Income Subject to Withholding,'' provided to the partner by the partnership.

(iii) *Tiered structures including trusts or estates*—(A) *Foreign trusts and estates.* Section 1446 tax paid on the portion of ECTI allocable under section 704 to a foreign trust or estate that the foreign trust or estate may claim as a credit under section 33 shall bear the same ratio to the total 1446 tax paid on behalf of the trust or estate as the total ECTI allocable to such trust or estate and not distributed (or treated as distributed) to the beneficiaries of such trust or estate, and, accordingly not deducted under section 651 or section 661 in calculating the trust or estate's taxable income, bears to the total ECTI allocable to such trust or estate. Any 1446 tax that a foreign trust or estate is not entitled to claim as a credit under this paragraph (d)(2) may be claimed as a credit by the beneficiary or beneficiaries of such trust or estate that includes the partnership's ECTI (distributed or deemed distributed) allocated to the trust or estate in gross income under section 652 or section 662 (with the same character as effectively connected income as in the hands of the trust or estate). The trust or estate must provide each beneficiary with a copy of the Form 8805 provided to it by the partnership and prepare the statement required by paragraph (d)(1)(iv) of this section.

(B) *Use of domestic trusts to circumvent section 1446.* This paragraph (d)(2)(iii)(B) shall apply if a partnership knows or has reason to know that a foreign person that is the ultimate beneficial owner of the ECTI holds its interest in the partnership through a domestic trust (and possibly other entities), and such domestic trust was formed or availed of with a principal purpose of avoiding the 1446 tax. The use of a domestic trust in a tiered trust structure may have a principal purpose of avoiding the 1446 tax even though the tax avoidance purpose is outweighed by other purposes when taken together. In such case, a partnership is required to pay 1446 tax under this paragraph as if the domestic trust was a foreign trust for purposes of section 1446 and the regulations thereunder. Accordingly, all applicable penalties and interest shall apply to the partnership for its failure to pay 1446 tax under this paragraph (d)(2)(iii)(B), commencing with the installment period during which the partnership knew or had reason to know that this paragraph (d)(2)(iii)(B) applied.

(iv) *Refunds to withholding agent.* A partnership (or nominee pursuant to § 1.1446–4) may apply for a refund of the 1446 tax paid only to the extent allowable under section 1464 and the regulations thereunder.

(v) *1446 tax treated as cash distribution to partners.* Amounts paid by a partnership under section 1446 with respect to a partner are treated as distributed to that partner on the earliest of the day on which such tax was paid by the partnership, the last day of the partnership taxable year for which the tax was paid, or, the last day during the partnership's taxable year on which the partner owned an interest in the partnership. Thus, for example, 1446 tax paid by a partnership after the close of a partnership taxable year that relates to ECTI allocable to a foreign partner for the prior taxable year will be considered distributed by the partnership to the respective foreign partner on the last day of the partnership's prior taxable year.

(vi) *Examples.* The following examples illustrate the application of this section:

Example 1. Simple trust that reports entire amount of ECTI. PRS is a partnership that has two partners, FT, a foreign trust, and A, a U.S. person. FT is a simple trust under section 651. FT and A each provide PRS with a valid Form W–8BEN and Form W–9, respectively. FT has one beneficiary, NRA, a nonresident alien individual. In computing its installment obligation during the 2004 taxable year, PRS has $200 of annualized income, all of which is ordinary ECTI. The $200 of income will be allocated equally to FT and A under section 704 and it is assumed that such an allocation will be respected under section 704(b) and the regulations thereunder. FT's allocable share of ECTI is $100. PRS withholds $35 under section 1446 with respect to the $100 of ECTI allocable to FT. FT's only income for its tax year is the $100 of income from PRS. Pursuant to the terms of the trust's governing instrument and local law, the $100 of ECTI is not included in FT's fiduciary accounting income and the deemed distribution of the $35 withholding tax paid under paragraph (d)(2)(v) of this section is not included in FT's fiduciary accounting income. Accordingly, the $100 of ECTI is not income required to be distributed by FT, and FT may not claim a deduction under section 651 for this amount. FT must report the $100 of ECTI in its gross income and may claim a credit under section 33 in the amount of $35 for the 1446 tax paid by PRS. NRA is not required to include any of the ECTI in gross income and accordingly may not claim a credit for any amount of the $35 of 1446 tax paid by PRS.

Example 2. Simple trust that distributes a portion of ECTI to the beneficiary.

Assume the same facts as in *Example 1,* except that PRS distributes $60 to FT, which is included in FT's fiduciary accounting income under local law. FT will report the $100 of ECTI in its gross income and may claim a deduction for the $60 required to be distributed under section 651(a) to NRA. Pursuant to paragraph (d)(2)(iii) of this section, FT may claim a credit under section 33 in the amount of $14 for the 1446 tax paid by PRS ($40/$100 multiplied by $35). NRA is required to include the $60 of the ECTI in gross income under section 652 (as ECTI) and may claim a credit under section 33 in the amount of $21 for the 1446 tax paid by PRS ($35 less $14 or $60/$100 multiplied by $35).

Example 3. Complex trust that distributes entire ECTI to the beneficiary. Assume the same facts as in *Example 1,* except that FT is a complex trust under section 661. PRS distributes $60 to FT, which is included in FT's fiduciary accounting income. FT distributes the $60 of fiduciary accounting income to NRA and also properly distributes an additional $40 to NRA from FT's principal. FT will report the $100 of ECTI in its gross income and may deduct the $60 required to be distributed to NRA under section 661(a)(1) and may deduct the $40 distributed to NRA under section 661(a)(2). FT may not claim a credit under section 33 for any of the $35 of 1446 tax paid by PRS. NRA is required to include $100 of the ECTI in gross income under section 662 (as ECTI) and may claim a credit under section 33 in the amount of $35 for the 1446 tax paid by PRS ($35 less $0).

(e) *Liability of partnership for failure to withhold*—(1) *In general.* Every partnership required to pay a 1446 tax is made liable for that tax by section 1461. Therefore, a partnership that is required to pay a 1446 tax but fails to do so, or pays less than the amount required under this section, is liable under section 1461 for the payment of the tax required to be withheld under chapter 3 of the Internal Revenue Code and the regulations thereunder unless the partnership can demonstrate pursuant to paragraph (e)(2) of this section, to the satisfaction of the Commissioner or his delegate, that the full amount of effectively connected taxable income allocable to such partner was included in income on the partner's U.S. Federal income tax return and the full amount of tax due on such return was paid by such partner to the Internal Revenue Service. See paragraph (e)(3) of this section and section 1463 regarding the partnership's liability for penalties and interest even though a foreign partner has satisfied the underlying tax liability. See § 1.1461–3 for applicable penalties when a partnership fails to pay 1446 tax. See paragraph (b) of this section for an addition to tax under section 6655 when there is an underpayment of 1446 tax.

(2) *Proof that tax liability has been satisfied.* Proof of payment of tax may be established for purposes of paragraph (e)(1) of this section on the basis of a Form 4669, ''Statement of Payments Received,'' or such other form as the Internal Revenue Service may prescribe

in published guidance (see § 601.601(d)(2) of this chapter), establishing the amount of tax, if any, actually paid by the partner on the income. Such partnership's liability for tax, and the requirement that such partnership file Forms 8804 and 8805 shall be deemed to have been satisfied with respect to such partner as of the date on which the partner's income tax return was filed and all tax required to be shown on the return is paid in full.

(3) *Liability for interest and penalties.* Notwithstanding paragraph (e)(2) of this section, a partnership that fails to pay over tax under section 1446 is not relieved from liability under section 6655 or for interest under section 6601. See § 1.1463–1. Such liability may exist even if there is no underlying tax liability due from a foreign partner on its allocable share of partnership ECTI. The addition to tax under section 6655 or the interest charge under section 6601 that is required by those sections shall be imposed as set forth in those sections, as modified by this section. For example, under section 6601, interest shall accrue beginning on the last date for paying the tax due under section 1461 (which is the due date, without extensions, for filing the Forms 8804 and 8805). The interest shall stop accruing on the 1446 tax liability on the date, and to the extent, that the unpaid tax liability under section 1446 is satisfied. A foreign partner is permitted to reduce any addition to tax under section 6654 or 6655 by the amount of any section 6655 addition to tax paid by the partnership with respect to its failure to pay adequate installment payments of the 1446 tax on ECTI allocable to the foreign partner.

(f) *Effect of withholding on partner.* The payment of the 1446 tax by a partnership does not excuse a foreign partner to which a portion of ECTI is allocable from filing a U.S. tax or informational return, as appropriate, with respect to that income. Information concerning installment payments of 1446 tax paid during the partnership's taxable year on behalf of a foreign partner shall be provided to such foreign partner in accordance with paragraph (d) of this section and such information may be taken into account by the foreign partner when computing the partner's estimated tax liability during the taxable year. Form 1040NR, ''U.S. Nonresident Alien Income Tax Return,'' Form 1065, ''U.S. Return of Partnership Income,'' Form 1120F, ''U.S. Income Tax Return of a Foreign Corporation,'' or such other return as appropriate, must be filed by the partner, and any tax due must be paid, by the filing deadline (including extensions) generally applicable to such person. Pursuant to § 1.1446–3(d), a partner may generally claim a credit under section 33 for its share of any 1446 tax paid by the partnership against the amount of income tax (or 1446 tax in the case of tiers of partnerships) as computed in such partner's return.

§ 1.1446–4 Publicly traded partnerships.

(a) *In general.* This section sets forth rules for applying the section 1446 withholding tax (1446 tax) to publicly traded partnerships. A publicly traded partnership (as defined in paragraph (b) of this section) that has effectively connected gross income, gain or loss must pay 1446 tax by withholding from distributions to a foreign partner. Publicly traded partnerships that withhold on distributions must pay over and report any 1446 tax as provided in paragraph (c), and generally are not to pay over and report the 1446 tax under the rules in § 1.1446–3. However, under paragraph (g) of this section, a publicly traded partnership may elect not to apply the rules of this section, and instead, to pay the 1446 tax based on the effectively connected taxable income (ECTI) allocable under section 704 to foreign partners under the general rules of §§ 1.1446–1 through 1.1446–3. The amount of the withholding tax on distributions, other than distributions excluded under paragraph (f) of this section, that are made during any partnership taxable year, equals the applicable percentage (defined in paragraph (b)(2) of this section) of such distributions.

(b) *Definitions*—(1) *Publicly traded partnership.* For purposes of this section, the term publicly traded partnership has the same meaning as in section 7704 (including the regulations thereunder), but does not include a publicly traded partnership treated as a corporation under that section.

(2) *Applicable percentage.* For purposes of this section, applicable percentage shall have the meaning as set forth in § 1.1446–3(a)(2).

(3) *Nominee.* For purposes of this section, the term nominee means a domestic person that holds an interest in a publicly traded partnership on behalf of a foreign person.

(4) *Qualified notice.* For purposes of this section, a qualified notice is a notice given by a publicly traded partnership regarding a distribution that is attributable to effectively connected income, gain or loss of the partnership, and in accordance with the notice requirements with respect to dividends described in 17 CFR 240.10b–17(b)(1) or (3) issued pursuant to the Securities Exchange Act of 1934, 15 U.S.C. section 78(a).

(c) *Time and manner of payment.* The withholding tax required under this section is to be paid pursuant to the rules and procedures of section 1461, §§ 1.1461–1, 1.1461–2, and 1.6302–2. However, the reimbursement and set-off procedures set forth in those regulations shall not apply. A publicly traded partnership must use Form 1042, ''Annual Withholding Tax Return for U.S. Source Income of Foreign Persons,'' and Form 1042–S, ''Foreign Person's U.S. Source Income Subject to Withholding,'' to report withholding from distributions under this section. See § 1.1461–1(b). See § 1.1446–3(d)(1)(vii) requiring a foreign trust or estate that holds an interest in a publicly traded partnership to provide a statement to the beneficiaries of such foreign trust or estate with respect to the credit to be claimed under section 33. For penalties and additions to the tax for failure to comply with this section, see §§ 1.1461–1 and 1.1461–3.

(d) *Rules for designation of nominees to withhold tax under section 1446.* A nominee that receives a distribution from a publicly traded partnership subject to withholding under this section, and which is to be paid to (or for the account of) any foreign person, may be treated as a withholding agent under this section. A nominee is treated as a withholding agent under this section only to the extent of the amount specified in the qualified notice (as defined in paragraph (b)(4) of this section) that the nominee receives. Where a nominee is designated as a withholding agent with respect to a foreign partner of the partnership, then the obligation to withhold on distributions to such foreign partner in accordance with the rules of this section shall be imposed solely on the nominee. A nominee under this section shall identify itself as a nominee by providing Form W–9, ''Request for Taxpayer Identification Number and Certification,'' to the partnership, along with the statement required by paragraph (e)(1) of this section. If a nominee furnishes Form W–9 and the statement required by paragraph (e)(1) of this section to the partnership, but a qualified notice is not received by the nominee from the partnership, the nominee shall not be a withholding agent subject to the rules of this section and the partnership shall presume that such nominee is a nonresident alien individual or foreign corporation, whichever classification results in a higher 1446 tax being due, and pay a withholding tax consistent with such presumption. A nominee responsible for

withholding under the rules of this section shall be subject to liability under sections 1461 and 6655, as well as for all applicable penalties and interest, as if such nominee was a partnership responsible for withholding under this section.

(e) *Determining foreign status of partners*—(1) *In general.* Except as provided in paragraph (d) of this section permitting nominees to submit a Form W–9 to a publicly traded partnership, the rules of § 1.1446–1 shall apply in determining whether a partner of a publicly traded partnership is a foreign partner for purposes of the 1446 tax (see § 1.1446–4(a)) and a nominee obligated to withhold under this section shall be entitled to rely on a Form W–8BEN, ''Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding,'' Form W–8IMY, ''Certificate of Foreign Intermediary, Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding,'' or Form W–9, ''Request for Taxpayer Identification Number,'' received from persons on whose behalf it holds interests in the partnership to the same extent a partnership is entitled to rely on such forms under those rules. In addition to the rules stated in §§ 1.1446–1 through 1.1446–3 with respect to certificates establishing a partner as a domestic or foreign person, a nominee shall attach a brief statement to the Form W–9 that it furnishes to the partnership, informing the partnership that the nominee holds interests in the partnership on behalf of one or more foreign persons, including information that permits the partnership to determine the partnership interest held on behalf of such foreign persons. A statement furnished by a nominee pursuant to § 1.6031(c)–1T satisfies the requirements of the previous sentence.

(2) *Presumptions regarding payee's status in absence of documentation.* The rules of § 1.1446–1(c)(3) shall apply to determine a partner's status in the absence of documentation.

(f) *Distributions subject to withholding*—(1) *In general.* Except as provided in this paragraph (f)(1), a publicly traded partnership must withhold at the applicable percentage with respect to any actual distribution made to a foreign partner. The amount of a distribution subject to 1446 tax includes the amount of any 1446 tax required to be withheld on the distribution and, in the case of a partnership that receives a partnership distribution from another partnership in which it is a partner (*i.e.*, a tiered structure described in § 1.1446–5), any 1446 tax that was withheld from such distribution. For example, a foreign publicly traded partnership, UTP, owns an interest in domestic publicly traded partnership, LTP. UTP does not provide LTP any documentation with respect to its domestic or foreign status. LTP and UTP each have a calendar taxable year. LTP makes a distribution subject to section 1446 of $100 to UTP during its taxable year beginning January 1, 2004, and withholds 35 percent (the highest rate in section 1) of that distribution under section 1446. UTP receives a net distribution of $65 which it immediately redistributes to its partners. UTP has a liability to pay 35 percent of the total actual and deemed distribution it makes to its foreign partners as a section 1446 withholding tax. UTP may credit the $35 withheld by LTP against this liability as if it were paid by UTP. When UTP distributes the $65 it actually receives from LTP to its partners, UTP is treated for purposes of section 1446 as if it made a distribution of $100 to its partners ($65 actual distribution and $35 deemed distribution). UTP's partners (U.S. and foreign) may claim a credit against their U.S. income tax liability for their allocable share of the $35 of 1446 tax paid on their behalf.

(2) *In-kind distributions.* If a publicly traded partnership distributes property other than money, the partnership shall not release the property until it has funds sufficient to enable the partnership to pay over in money the required 1446 tax.

(3) *Ordering rule relating to distributions.* Distributions from publicly traded partnerships are deemed to be paid out of the following types of income in the order indicated—

(i) Amounts attributable to income described in section 1441 or 1442 that are not effectively connected, without regard to whether such amounts are subject to withholding because of a treaty or statutory exemption;

(ii) Amounts attributable to recurring dispositions of crops and timber that are subject to withholding under § 1.1445–5(c)(3)(iv) of the regulations, which continue to be subject to the rules of § 1.1445–5(c)(3);

(iii) Amounts effectively connected with a U.S. trade or business, but not subject to withholding under section 1446 (*e.g.*, exempt by treaty);

(iv) Amounts subject to withholding under section 1446; and

(v) Amounts not listed in paragraphs (f)(3)(i) through (iv) of this section.

(4) *Coordination with section 1445(e)(1).* Except as otherwise provided in this section, a publicly traded partnership that complies with the requirements of withholding under section 1446 and this section will be deemed to have satisfied the requirements of section 1445(e)(1) and the regulations thereunder. Notwithstanding the excluded amounts set forth in paragraph (f)(3) of this section, distributions subject to withholding at the applicable percentage shall include the following—

(i) Amounts subject to withholding under section 1445(e)(1) upon distribution pursuant to an election under § 1.1445–5(c)(3); and

(ii) Amounts not subject to withholding under section 1445 because the distributee is a partnership or is a foreign corporation that has made an election under section 897(i).

(g) *Election to withhold based upon ECTI allocable to foreign partners instead of withholding on distributions.* A publicly traded partnership may elect to comply with the requirements of §§ 1.1446–1 through 1.1446–3 (relating to withholding on ECTI allocable to foreign partners) and § 1.1446–5 (relating to tiered partnership structures) instead of the rules of this section. A publicly traded partnership shall make the election described in this paragraph (g) by complying with the payment and reporting requirements of §§ 1.1446–1 through 1.1446–3 and by complying with the information reporting requirements of this paragraph (g). The election is made by attaching a statement to a timely filed Form 8804, ''Annual Return for Partnership Withholding Tax (Section 1446),'' that is required to be filed by the partnership for the taxable year, indicating that the partnership is a publicly traded partnership that is electing to pay the 1446 tax under section 1446 based upon ECTI allocable under section 704 to its foreign partners. Once made, an election under this paragraph (g) may be revoked only with the consent of the Commissioner.

§ 1.1446–5 Tiered partnership structures.

(a) *In general.* The rules of this section shall apply in cases where a partnership (lower-tier partnership) that has effectively connected taxable income (ECTI), has a partner that is itself a partnership (upper-tier partnership). A partnership that directly or indirectly (through a chain of partnerships) owns a partnership interest in a lower-tier partnership shall be allowed a credit against its own section 1446 withholding tax (1446 tax) for the tax paid by the lower-tier partnership on its behalf. If an upper-tier domestic partnership directly owns an interest in a lower-tier partnership, the lower-tier partnership is not required to pay a withholding tax with respect to the upper-tier partnership's allocable share

of effectively connected taxable income (ECTI), regardless of whether the upper-tier domestic partnership's partners are foreign.

(b) *Reporting requirements*—(1) *In general.* To the extent that an upper-tier partnership that is a foreign partnership is a partner in a lower-tier partnership, and the lower-tier partnership has made 1446 tax installment payments on ECTI allocable to the upper-tier partnership, the upper-tier partnership shall receive a copy of the statements and forms filed by the lower-tier partnership allocable to its partnership interest in the lower-tier partnership under §§ 1.1446–1 through 1.1446–3 (*e.g.*, Form 8805, ''Foreign Partner's Information Statement of Section 1446 Withholding Tax''). The upper-tier partnership may treat the 1446 tax paid by the lower-tier partnership on its behalf as a credit against its liability to pay 1446 tax, as if the upper-tier partnership actually paid over the amounts at the time that the amounts were paid by the lower-tier partnership. See § 1.1462–1(b). However, the upper-tier partnership may not obtain a refund for the amounts paid by the lower-tier partnership, but instead, must file such forms as prescribed by § 1.1446–3 and this section to allow the credits under section 33 to be properly claimed by the beneficial owners of such income. See § 1.1462–1. The upper-tier partnership must file Form 8804, ''Annual Return for Partnership Withholding Tax (Section 1446),'' and Form 8805, ''Foreign Partner's Information Statement of Section 1446 Withholding Tax,'' with respect to its 1446 tax obligation, passing the credit for 1446 tax paid by the lower-tier partnership to its partners.

(2) *Publicly traded partnerships.* In the case of an upper-tier foreign partnership that is a publicly traded partnership, the rules of § 1.1446–4(c) shall apply.

(c) *Look through rules for foreign upper-tier partnerships.* For purposes of computing the 1446 tax obligation of a lower-tier partnership, if an upper-tier partnership owns an interest in the lower-tier partnership, the upper-tier partnership's allocable share of the lower-tier partnership's ECTI shall be treated as allocable to the partners of the upper-tier partnership (as if they were direct partners in the lower-tier partnership) to the extent that—

(1) The upper-tier partnership furnishes the lower-tier partnership with a valid Form W–8IMY, ''Certificate of Foreign Intermediary, Flow Through Entity, or Certain U.S. Branches for United States Tax Withholding,'' indicating that it is a look-through foreign partnership for purposes of section 1446, and

(2) The lower-tier partnership can reliably associate (within the meaning of § 1.1441–1(b)(2)(vii)) the effectively connected partnership items allocable to the upper-tier partnership with a Form W–8BEN, ''Certificate of Foreign Status of Beneficial Owner for U.S. Tax Withholding,'' Form W–8IMY, or Form W–9, ''Request for Taxpayer Identification Number and Certification,'' for each of the upper-tier partnership's partners. The principles of § 1.1441–1(b)(2)(vii) shall apply to determine whether a lower-tier partnership can reliably associate effectively connected partnership items allocable to the upper-tier partnership to the partners of the upper-tier partnership. The upper-tier partnership shall provide the lower-tier partnership with a withholding certificate for each partner in the upper-tier partnership and information regarding the allocation of effectively connected items to the respective partners of the upper-tier partnership. To the extent the lower-tier partnership receives a valid Form W–8IMY from the upper-tier partnership but cannot reliably associate the upper-tier partnership's allocable share of effectively connected partnership items with a withholding certificate for each of the upper-tier partnership's partners, the lower-tier partnership shall withhold at the higher of the applicable percentages in section 1446(b). If a lower-tier partnership has not received a valid Form W–8IMY from the upper-tier partnership, the lower-tier partnership shall withhold at the higher of the applicable percentages in section 1446(b). See § 1.1446–1(c)(3). The approach set forth in this paragraph (c) shall not apply to partnerships whose interests are publicly traded. See § 1.1446–4.

(d) *Examples.* The following examples illustrate the provisions of § 1.1446–5:

Example 1. Sufficient documentation—tiered partnership structure. (i) Nonresident alien (NRA) and foreign corporation (FC) are partners in PRS, a foreign partnership, and share profits and losses in PRS 70 and 30 percent, respectively. All of PRS's partnership items are allocated based upon each partner's respective ownership interest and it is assumed that these allocations are respected under section 704(b) and the regulations thereunder. NRA and FC each furnish PRS with a valid Form W–8BEN establishing themselves as a foreign individual and foreign corporation, respectively. PRS holds a 40 percent interest in the profits, losses and capital of LTP, a lower-tier partnership. NRA holds the remaining 60 percent interest in profits, losses and capital of LTP. LTP has $100 of annualized ECTI for the relevant installment period. PRS has no income other than the income allocated from LTP. PRS provides LTP with a valid Form W–8IMY indicating that it is a foreign partnership and attaches the valid Form W–8BENs executed by NRA and FC, as well as a statement describing the allocation of PRS's effectively connected items among its partners. Further, NRA provides a valid Form W–8BEN to LTP.

(ii) LTP must pay 1446 tax on the $60 allocable to its direct partner NRA using the highest rate in section 1.

(iii) With respect to the effectively connected partnership items that LTP can reliably associate with NRA through PRS (70 percent of PRS's allocable share, or $28), LTP will pay 1446 tax on NRA's allocable share of LTP's partnership ECTI (as determined by looking through PRS) using the applicable percentage for non-corporate partners (the highest rate in section 1).

(iv) With respect to the effectively connected partnership items that LTP can reliably associate with FC through PRS (30 percent of PRS's allocable share, or $12), LTP will pay 1446 tax on FC's allocable share of LTP's ECTI (as determined by looking through PRS) using the applicable percentage for corporate partners.

(v) LTP's payment of the 1446 tax is treated as a distribution to NRA and PRS, its direct partners, that those partners may credit against their respective tax obligations. PRS will report its 1446 tax obligation with respect to its direct foreign partners, NRA and FC, on the Form 8804 and Form 8805 that it files with the Internal Revenue Service and will credit the amount withheld by LTP. Thus, PRS will pass along to NRA and FC the credit for the 1446 tax withheld by LTP which will be treated as a distribution to them.

Example 2. Insufficient documentation—tiered partnership structure. PRS is a domestic partnership that has two equal partners A and UTP. A is a nonresident alien individual and UTP is a foreign partnership that has two equal foreign partners, C and D. Neither A nor UTP provide PRS with a valid Form W–8BEN, Form W–8IMY, or Form W–9. Neither C nor D provide UTP with a valid Form W–8BEN, Form W–8IMY, or Form W–9. PRS must presume that UTP is a foreign person subject to withholding under section 1446 at the higher of the highest rate under section 1 or 11(b)(1). PRS has also not received any documentation with respect to A. PRS must presume that A is a foreign person, and, if PRS knows that A is an individual, compute and pay 1446 tax based on that knowledge.

§ 1.1446–6 Effective date.

Sections 1.1446–1 through 1.1446–5 shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register**.

Par. 5. Section 1.1461–1 is amended as follows:

1. Paragraph (a)(1) is amended by adding three sentences at the end of the paragraph.

2. The second sentence of paragraph (c)(1)(i) is removed and two sentences are added in its place.

3. Paragraph (c)(1)(ii)(A)(*8*) is redesignated as paragraph (c)(1)(ii)(A)(*9*), and a new paragraph (c)(1)(ii)(A)(*8*) is added.

4. The first sentence of paragraph (c)(2)(i) is removed and two sentences are added in its place.

5. The first sentence of paragraph (c)(3) is removed and two sentences are added in its place.

6. Paragraph (i) is revised.

The additions and revisions read as follows:

§ 1.1461–1 Payment and returns of tax withheld.

(a) * * *

(1) * * * With respect to withholding under section 1446, this section shall only apply to publicly traded partnerships that have not made an election under § 1.1446–4(g). See § 1.1461–3 for penalties applicable to partnerships that fail to withhold under section 1446 on effectively connected taxable income allocable to foreign partners, including a publicly traded partnership that has made an election under § 11446–4(g). The previous two sentences shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register**.

* * * * *

(c) * * *

(1) * * *

(i) * * * Notwithstanding the preceding sentence, any person that withholds or is required to withhold an amount under sections 1441, 1442, 1443, or § 1.1446–4(a) must file a Form 1042–S, ''Foreign Person's U.S. Source Income Subject to Withholding,'' for the payment withheld upon whether or not that person is engaged in a trade or business and whether or not the payment is an amount subject to reporting. The reference in the previous sentence to withholding under § 1.1446–4 shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register**.

* * *

(ii) * * *

(A) * * *

(*8*) A partner receiving a distribution from a publicly traded partnership subject to withholding under section 1446 and § 1.1446–4. This paragraph (c)(1)(ii)(A)(*8*) shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register**.

* * * * *

(2) *Amounts subject to reporting*—(i) *In general.* Subject to the exceptions described in paragraph (c)(2)(ii) of this section, amounts subject to reporting on Form 1042–S are amounts paid to a foreign payee or partner (including persons presumed to be foreign) that are amounts subject to withholding as defined in § 1.1441–2(a) or § 1.1446–4(a). The reference in the previous sentence to withholding under § 1.1446–4 shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register**.

* * *

* * * * *

(3) *Required information.* The information required to be furnished under this paragraph (c)(3) shall be based upon the information provided by or on behalf of the recipient of an amount subject to reporting (as corrected and supplemented based on the withholding agent's actual knowledge) or the presumption rules of §§ 1.1441–1(b)(3), 1.1441–4(a); 1.1441–5(d) and (e); 1.1441–9(b)(3), 1.1446–1(c)(3) or 1.6049–5(d). The reference in the previous sentence to presumption rules applicable to withholding under section 1446 shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register**.

* * *

* * * * *

(i) *Effective date.* Unless otherwise provided in this section, this section shall apply to returns required for payments made after December 31, 2000.

Par. 6. Section 1.1461–2 is amended by:

1. Removing the first sentence of paragraph (a)(1) and adding two sentences in its place.

2. Revising paragraphs (b) and (d).

The revisions and addition read as follows:

§ 1.1461–2 Adjustments for overwithholding or underwithholding of tax.

(a) *Adjustments of overwithheld tax*—(1) *In general.* Except for partnerships or nominees required to withhold under section 1446, a withholding agent that has overwithheld under chapter 3 of the Internal Revenue Code, and made a deposit of the tax as provided in § 1.6302–2(a) may adjust the overwithheld amount either pursuant to the reimbursement procedure described in paragraph (a)(2) of this section or pursuant to the set-off procedure described in paragraph (a)(3) of this section. References in the previous sentence excepting from this section certain partnerships withholding under section 1446 shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register**.

* * *

* * * * *

(b) *Withholding of additional tax when underwithholding occurs.* A withholding agent may withhold from future payments (or a partner's allocable share of ECTI under section 1446) made to a beneficial owner the tax that should have been withheld from previous payments (or paid under section 1446 with respect to a partner's allocable share of ECTI) to such beneficial owner under chapter 3 of the Internal Revenue Code. In the alternative, the withholding agent may satisfy the tax from property that it holds in custody for the beneficial owner or property over which it has control. Such additional withholding or satisfaction of the tax owed may only be made before the date that the annual return (*e.g.* Form 1042, Form 8804) is required to be filed (not including extensions) for the taxable year in which the underwithholding occurred. See § 1.6302–2 for making deposits of tax or § 1.1461–1(a) for making payment of the balance due for a calendar year. See also §§ 1.1461–1, 1.1461–3, and 1.1446–1 through 1.1446–5 for rules relating to withholding under section 1446. References in this paragraph (b) to withholding under section 1446 shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register**.

* * * * *

(d) *Effective date.* Unless otherwise provided in this section, this section applies to payments made after December 31, 2000.

Par. 7. Section 1.1461–3 is added to read as follows.

§ 1.1461–3 Withholding under section 1446.

For rules relating to the withholding tax liability of a partnership or nominee under section 1446, see §§ 1.1446–1 through 1.1446–6. For penalties and additions to the tax for failure to timely pay the tax required to be paid under section 1446, see sections 6655 (in the case of publicly traded partnerships that have not made an election under § 1.1446–4(g), see section 6656), 6672, and 7202 and the regulations under those sections. For penalties and additions to the tax for failure to file returns or furnish statements in accordance with the regulations under section 1446, see sections 6651, 6662, 6663, 6721, 6722, 6723, 6724(c), 7201, 7203, and the regulations under those sections. This section shall apply to partnership taxable years beginning after the date that these regulations are

published as final regulations in the **Federal Register**.

Par. 8. Section 1.1462–1 is amended by revising paragraphs (b) and (c) to read as follows:

§ 1.1462–1 Withheld tax as credit to recipient of income.

* * * * *

(b) *Amounts paid to persons who are not the beneficial owner.* Amounts withheld at source under chapter 3 of the Internal Revenue Code on payments to (or effectively connected taxable income allocable to) a fiduciary, partnership, or intermediary is deemed to have been paid by the taxpayer ultimately liable for the tax upon such income. Thus, for example, if a beneficiary of a trust is subject to the taxes imposed by section 1, 2, 3, or 11 upon any portion of the income received from a foreign trust, the part of any amount withheld at source which is properly allocable to the income so taxed to such beneficiary shall be credited against the amount of the income tax computed upon the beneficiary's return, and any excess shall be refunded. See § 1.1446–3 for examples applying this rule in the context of a partnership interest held through a foreign trust or estate. Further, if a partnership withholds an amount under chapter 3 of the Internal Revenue Code with respect to the distributive share of a partner that is a partnership or with respect to the distributive share of partners in an upper-tier partnership, such amount is deemed to have been withheld by the upper-tier partnership. See § 1.1446–5 for rules applicable to tiered partnership structures. References in this paragraph (b) to withholding under section 1446 shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register**.

(c) *Effective date.* Unless otherwise provided in this section, this section applies to payments made after December 31, 2000.

Par. 9. Section 1.1463–1 is amended by:

1. Adding two sentences at the end of paragraph (a).

2. Revising paragraph (b).

The addition and revision read as follows:

§ 1.1463–1 Tax paid by recipient of income.

(a) * * * See § 1.1446–3(f) for additional rules where the tax was required to be withheld under section 1446. The reference in the previous sentence to withholding under section 1446 shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register**.

(b) *Effective date.* Unless otherwise provided in this section, this section applies to failures to withhold occurring after December 31, 2000.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 10. The authority for 26 CFR part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 11. In § 301.6109–1 is amended as follows:

1. In paragraph (b)(2)(vi), remove the word ''and''.

2. In paragraph (b)(2)(vii), remove the period at the end of the paragraph and add ''; and'' in its place.

3. Paragraph (b)(2)(viii) is added.

4. In paragraph (c), the first three sentences are revised and a sentence is added at the end of the paragraph.

The amendments and additions read as follows:

§ 301.6109–1 Identifying numbers.

* * * * *

(b) * * *

(2) * * *

(viii) A foreign person that furnishes a withholding certificate described in § 1.1446–1(c)(2) or (3) of this chapter. This paragraph (b)(2)(viii) shall apply to partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

(c) *Requirement to furnish another's number.* Every person required under this title to make a return, statement, or other document must furnish such taxpayer identifying numbers of other U.S. persons and foreign persons that are described in paragraph (b)(2)(i), (ii), (iii), (vi), (vii), or (viii) of this section as required by the forms and the accompanying instructions. The taxpayer identifying number of any person furnishing a withholding certificate referred to in paragraph (b)(2)(vi) or (viii) of this section shall also be furnished if it is actually known to the person making a return, statement, or other document described in this paragraph (c). If the person making the return, statement, or other document does not know the taxpayer identifying number of the other person, and such other person is one that is described in paragraph (b)(2)(i), (ii), (iii), (vi), (vii), or (viii) of this section, such person must request the other person's number. * * * References in this paragraph (c) to paragraph (b)(2)(viii) of this section shall apply to partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

* * * * *

Par. 12. In § 301.6721–1, paragraph (g)(4) is revised to read as follows:

§ 301.6721–1 Failure to file correct information returns.

* * * * *

(g) * * *

(4) *Other items.* The term *information return* also includes any form, statement, or schedule required to be filed with the Internal Revenue Service with respect to any amount from which tax is required to be deducted and withheld under chapter 3 of the Internal Revenue Code (or from which tax would be required to be so deducted and withheld but for an exemption under the Internal Revenue Code or any treaty obligation of the United States), generally Forms 1042–S, ''Foreign Person's U.S. Source Income Subject to Withholding,'' and 8805, ''Foreign Partner's Information Statement of Section 1446 Withholding Tax.'' The provisions of this paragraph (g)(4) referring to Form 8805, shall apply to partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

Robert E. Wenzel,

Deputy Commissioner for Services and Enforcement.

[FR Doc. 03–22175 Filed 9–2–03; 8:45 am]

BILLING CODE 4830–01–P