Internal Revenue
bulletin

Bulletin No. 2005-23
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HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2005–32, page 1156.

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for June 2005.

Rev. Rul. 2005–33, page 1155.

Insurance companies; premium stabilization reserves. This ruling holds that additions to premium stabilization reserves are return premiums for purposes of determining the amount of premiums earned on insurance contracts during a taxable year.

T.D. 9200, page 1158.
REG–108524–00, page 1209.

Final, temporary, and proposed regulations under section 1446 of the Code provide guidance on the withholding tax liability of a partnership with income that is effectively connected with its U.S. trade or business, all or a portion of which is allocable under section 704 to foreign partners. The regulations also provide rules permitting a partnership under certain circumstances to consider partner-level deductions and losses when computing its section 1446 withholding tax obligation with respect to a foreign partner. A public hearing on the proposed regulations is scheduled for October 3, 2005.

Notice 2005–41, page 1203.

Charitable contributions; qualified intellectual property. This notice explains how amendments to section 170 of the Code made by the American Jobs Creation Act of 2004 limit the initial charitable contribution deduction allowable to a donor of qualified intellectual property. The notice also provides guidance on how, under the amendments, the donor may qualify for additional charitable contribution deductions based on the income received by or accrued to the donee organization with respect to the donated property.

Notice 2005–42, page 1204.

This notice allows employers sponsoring cafeteria plans the option to amend the cafeteria plan document to provide a grace period after the end of the plan year, during which unused benefits or contributions remaining at the end of the immediately preceding plan year may be paid or reimbursed to participants for qualified benefit expenses incurred during the grace period. The grace period must not extend beyond the fifteenth day of the third calendar month following the end of the immediately preceding plan year.

ADMINISTRATIVE

T.D. 9201, page 1153.

Final regulations under section 330 of title 31 of the U.S. Code modify section 10.35 which prescribes specific requirements for covered opinions. Certain written advice issued after a tax return is filed, advice provided by taxpayer's in-house counsel, and negative advice are excluded from the requirements of covered opinions. These regulations also clarify "principal purpose" and "prominently disclose".

(Continued on the next page)

Actions Relating to Court Decisions is on the page following the Introduction.
Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

Rev. Proc. 2005–32, page 1206.
This procedure provides guidance on when an IRS examination is considered closed, when a closed examination may be reopened (to include reinspecting a taxpayer's books of account), and who may approve a reopening. The procedure also describes by category certain IRS contacts with taxpayers and other actions taken as to taxpayers that are not examinations, inspections of books of account, or reopenings. Rev. Proc. 94–68 modified and superseded.

Announcement 2005–41, page 1212.
This document contains corrections to final regulations and removal of temporary regulations (T.D. 9198, 2005–18 I.R.B. 972) that relate to the recognition of gain on certain distributions of stock or securities of a controlled corporation in connection with an acquisition.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Actions Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce at an early date whether it will follow the holdings in certain cases. An Action on Decision is the document making such an announcement. An Action on Decision will be issued at the discretion of the Service only on unappealed issues decided adverse to the government. Generally, an Action on Decision is issued where its guidance would be helpful to Service personnel working with the same or similar issues. Unlike a Treasury Regulation or a Revenue Ruling, an Action on Decision is not an affirmative statement of Service position. It is not intended to serve as public guidance and may not be cited as precedent.

Actions on Decisions shall be relied upon within the Service only as conclusions applying the law to the facts in the particular case at the time the Action on Decision was issued. Caution should be exercised in extending the recommendation of the Action on Decision to similar cases where the facts are different. Moreover, the recommendation in the Action on Decision may be superseded by new legislation, regulations, rulings, cases, or Actions on Decisions.

Prior to 1991, the Service published acquiescence or nonacquiescence only in certain regular Tax Court opinions. The Service has expanded its acquiescence program to include other civil tax cases where guidance is determined to be helpful. Accordingly, the Service now may acquiesce or nonacquiesce in the holdings of memorandum Tax Court opinions, as well as those of the United States District Courts, Claims Court, and Circuit Courts of Appeal. Regardless of the court deciding the case, the recommendation of any Action on Decision will be published in the Internal Revenue Bulletin.

The recommendation in every Action on Decision will be summarized as acquiescence, acquiescence in result only, or nonacquiescence. Both "acquiescence" and "acquiescence in result only" mean that the Service accepts the holding of the court in a case and that the Service will follow it in disposing of cases with the same controlling facts. However, "acquiescence" indicates neither approval nor disapproval of the reasons assigned by the court for its conclusions; whereas, "acquiescence in result only" indicates disagreement or concern with some or all of those reasons. "Nonacquiescence" signifies that, although no further review was sought, the Service does not agree with the holding of the court and, generally, will not follow the decision in disposing of cases involving other taxpayers. In reference to an opinion of a circuit court of appeals, a "nonacquiescence" indicates that the Service will not follow the holding on a nationwide basis. However, the Service will recognize the precedential impact of the opinion on cases arising within the venue of the deciding circuit.

The Actions on Decisions published in the weekly Internal Revenue Bulletin are consolidated semiannually and appear in the first Bulletin for July and the Cumulative Bulletin for the first half of the year. A semiannual consolidation also appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner does NOT ACQUIESCE in the following decision:

Estate of Mitchell v. Commissioner,[1]
250 F.3d 696 (9th Cir. 2001), aff'g in part, rev'g in part, and remanding (T.C. Memo. 1997–461; on remand, T.C. Memo. 2002–98.

[1] Nonacquiescence relating to whether the Court of Appeals erred in shifting the burden of proving the valuation of stock to the Commissioner on the basis that the Commissioner's determination of the value of the stock was arbitrary and excessive.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2005. See Rev. Rul. 2005-32, page 1156.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of June 2005. See Rev. Rul. 2005-32, page 1156.

Section 330 (31 USC).—Best Practices for Tax Advisors

31 CFR 10.35: Requirements for covered opinions.

T.D. 9201

DEPARTMENT OF THE TREASURY
Office of the Secretary
31 CFR Part 10

Regulations Governing Practice Before the Internal Revenue Service

AGENCY: Office of the Secretary, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations revising the regulations governing practice before the Internal Revenue Service (Circular 230). These regulations affect individuals who practice before the Internal Revenue Service. These regulations clarify the standards for covered opinions.

DATES: *Effective Date*: These regulations are effective May 19, 2005.

Applicability Date: For dates of applicability, see §10.35(g).

FOR FURTHER INFORMATION CONTACT: Heather L. Dostaler at (202) 622–4940, or Brinton T. Warren at (202) 622–7800 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 330 of title 31 of the United States Code authorizes the Secretary of the Treasury to regulate practice before the Treasury Department. The Secretary has published the regulations in Circular 230 (31 CFR part 10). On December 20, 2004, the Treasury Department and the IRS published in the **Federal Register** (T.D. 9165, 2005–4 I.R.B. 357 [69 FR 75839]) final regulations (Final Regulations) applicable to written advice that is rendered after June 20, 2005. Since publication of the Final Regulations, Treasury and the IRS have received a number of comments highlighting areas where the language of the Final Regulations might have consequences inconsistent with their intent. Upon consideration of those comments, the Treasury Department and the IRS have made revisions to the Final Regulations, as described below, to clarify the language of the Final Regulations.

Explanation of Provisions

Written Advice Issued After a Tax Return is Filed

Commentators have expressed concern that advice given after a tax return is filed, in particular advice given in the context of an IRS examination or litigation, might constitute a covered opinion within the meaning of the Final Regulations. In response to this concern, the definition of *excluded advice* in §10.35 is expanded to include written advice prepared for and provided to a taxpayer, solely for use by that taxpayer, after the taxpayer has filed a tax return reflecting the tax benefits of the transaction described in or referred to in the written advice. This exclusion does not apply if the practitioner knows or has reason to know that the taxpayer will rely upon the written advice to take a position on a return (including an amended return that claims tax benefits not reported on the original return) filed after the date on which the advice is provided to the taxpayer.

Advice Provided by Taxpayer's In-House Counsel

Commentators have also expressed concern that written advice provided by in-house counsel to the employer for purposes of determining the employer's tax liability could constitute a covered opinion and that the concept of a covered opinion in that context raises numerous issues. In response to these concerns, the definition of *excluded advice* in §10.35 is expanded to include advice provided to an employer by a practitioner in that practitioner's capacity as an employee of that employer solely for purposes of determining the tax liability of the employer. Written advice provided by in-house counsel that falls within the revised definition of excluded advice will continue to be subject to the requirements set forth in §10.37 for other written advice. The exclusion of written advice provided by in-house counsel from the covered opinion standards of §10.35 is in no way intended to affect other aspects of the relationship between in-house counsel and the employer, such as whether, and in what circumstances, the attorney-client privilege applies to communications involving in-house counsel, or the circumstances in which written advice provided by in-house counsel might be relevant to determining the employer's good faith and reasonable cause.

Negative Advice

Several commentators have suggested that negative advice, *i.e.*, advice concluding that a Federal tax issue will not be resolved in the taxpayer's favor, could constitute a covered opinion. This concern is most prevalent (1) in the context of written advice relating to a listed transaction or a transaction having the principal purpose of tax avoidance and (2) where written advice addresses more than one Federal tax issue and the advice concludes that one or more Federal tax issues will not be resolved in the taxpayer's favor.

Treasury and the IRS encourage practitioners to advise taxpayers that a transaction is not appropriate or that one or more Federal tax issues will not be resolved in the taxpayer's favor. Treasury and the IRS

are concerned, however, about written advice that could be construed as encouraging taxpayers to take aggressive positions on their tax returns, such as advice that concludes one or more Federal tax issues will not be resolved in the taxpayer's favor, but also reaches a conclusion favorable to the taxpayer at any confidence level (*e.g.*, not frivolous, realistic possibility of success, reasonable basis or substantial authority) with respect to that issue(s). Consequently, the regulations are revised to provide that written advice that concludes that a Federal tax issue will not be resolved in the taxpayer's favor is not a covered opinion with respect to that issue, unless the written advice also reaches a conclusion favorable to the taxpayer at any confidence level (*e.g.*, not frivolous, realistic possibility of success, reasonable basis or substantial authority) with respect to that issue. If written advice concerns more than one Federal tax issue, the advice must comply with the requirements of §10.35(c) with respect to any Federal tax issue that is not treated as excluded advice pursuant to the preceding sentence.

Prominently Disclosed

Commentators have raised questions about how to apply the definition of *prominently disclosed* under §10.35(b)(8). The prominent disclosure requirement is intended to ensure transparency between taxpayers and practitioners and to provide taxpayers with notice of any limitation on their ability to rely on written advice. To achieve these goals while minimizing the burden of compliance on practitioners, these regulations modify the definition of prominently disclosed.

Transactions with The Principal Purpose of Tax Avoidance or Evasion

Commentators have asked for clarification of the term *the principal purpose* of tax avoidance or evasion and in particular have asked whether the definition in 26 CFR 1.6662–4(g)(2)(i) and (ii) is incorporated into §10.35. In response, these regulations define the principal purpose in §10.35(b)(10) similar to the definition in 26 CFR 1.6662–4(g)(2)(ii). This definition also provides that a transaction can be a listed transaction or can have a significant purpose of tax avoidance even if it lacks the principal purpose of tax avoidance. Practitioners must evaluate transactions under the rules in §10.35(b)(2)(i)(A) and (C), even if those transactions are not covered by §10.35(b)(2)(i)(B) because they do not have the principal purpose of avoidance or evasion within the meaning of §10.35(b)(10) of these regulations.

Special Analyses

This final rule clarifies and narrows the application of final regulations published in the **Federal Register** on December 20, 2004 (69 FR 75839). Accordingly, pursuant to 5 U.S.C. 553(b)(B), there is good cause to issue this final rule without prior notice and opportunity for public comment, because such would be contrary to the public interest. For these same reasons, and because the previously published final regulations apply to written advice rendered after June 20, 2005, under 5 U.S.C. 553(d)(1) and (3) a delayed effective date is not required. This final rule is not a significant regulatory action for purposes of Executive Order 12866. Accordingly, a regulatory impact analysis is not required. Because no notice of proposed rulemaking is required, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

Drafting Information

The principal author of the regulations is Heather L. Dostaler of the Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

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Adoption of Amendments to the Regulations

Accordingly, 31 CFR part 10 is amended as follows:

PART 10 — PRACTICE BEFORE THE INTERNAL REVENUE SERVICE

Paragraph 1. The authority citation for 31 CFR part 10 continues to read as follows:

[Authority: Sec. 3, 23 Stat. 258, secs. 2–12, 60 Stat. 237 *et. seq.*; 5 U.S.C. 301, 500, 551–559; 31 U.S.C. 330, 118 Stat. 1418; Reorg. Plan No. 26 of 1950, 15 FR 4935, 64 Stat. 1280, 3 CFR, 1949–1953 Comp., P. 1017.]

Par. 2. Section 10.35 is amended by:

1. Revising paragraph (b)(2)(ii).
2. Revising paragraph (b)(8).
3. Adding paragraph (b)(10).

The additions and revisions read as follows:

§10.35 Requirements for covered opinions.

* * * * *

(b) * * *

(2) * * *

(ii) *Excluded advice*. A *covered opinion* does not include—

(A) Written advice provided to a client during the course of an engagement if a practitioner is reasonably expected to provide subsequent written advice to the client that satisfies the requirements of this section;

(B) Written advice, other than advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions) or paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion) that—

(*1*) Concerns the qualification of a qualified plan;

(*2*) Is a *State or local bond opinion*; or

(*3*) Is included in documents required to be filed with the Securities and Exchange Commission;

(C) Written advice prepared for and provided to a taxpayer, solely for use by that taxpayer, after the taxpayer has filed a tax return with the Internal Revenue Service reflecting the tax benefits of the transaction. The preceding sentence does not apply if the practitioner knows or has reason to know that the written advice will be relied upon by the taxpayer to take a position on a tax return (including for these purposes an amended return that claims tax benefits not reported on a previously filed return) filed after the date on which the advice is provided to the taxpayer;

(D) Written advice provided to an employer by a practitioner in that practitioner's capacity as an employee of that employer solely for purposes of determining the tax liability of the employer; or

(E) Written advice that does not resolve a Federal tax issue in the taxpayer's favor, unless the advice reaches a conclusion favorable to the taxpayer at any confidence level (*e.g.*, not frivolous, realistic possibility of success, reasonable basis or substantial authority) with respect to that issue.

If written advice concerns more than one Federal tax issue, the advice must comply with the requirements of paragraph (c) of this section with respect to any Federal tax issue not described in the preceding sentence.

* * * * *

(8) *Prominently disclosed.* An item is prominently disclosed if it is readily apparent to a reader of the written advice. Whether an item is readily apparent will depend on the facts and circumstances surrounding the written advice including, but not limited to, the sophistication of the taxpayer and the length of the written advice. At a minimum, to be prominently disclosed an item must be set forth in a separate section (and not in a footnote) in a typeface that is the same size or larger than the typeface of any discussion of the facts or law in the written advice.

* * * * *

(10) *The principal purpose*. For purposes of this section, the principal purpose of a partnership or other entity, investment plan or arrangement, or other plan or arrangement is the avoidance or evasion of any tax imposed by the Internal Revenue Code if that purpose exceeds any other purpose. The principal purpose of a partnership or other entity, investment plan or arrangement, or other plan or arrangement is not to avoid or evade Federal tax if that partnership, entity, plan or arrangement has as its purpose the claiming of tax benefits in a manner consistent with the statute and Congressional purpose. A partnership, entity, plan or arrangement may have a significant purpose of avoidance or evasion even though it does not have the principal purpose of avoidance or evasion under this paragraph (b)(10).

* * * * *

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement, Internal Revenue Service.

Approved May 12, 2005.

James W. Carroll,
Acting General Counsel, Department of the Treasury.

(Filed by the Office of the Federal Register on May 18, 2005, 8:45 a.m., and published in the issue of the Federal Register for May 19, 2005, 70 F.R. 28824)

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of June 2005. See Rev. Rul. 2005-32, page 1156.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2005. See Rev. Rul. 2005-32, page 1156.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2005. See Rev. Rul. 2005-32, page 1156.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2005. See Rev. Rul. 2005-32, page 1156.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of June 2005. See Rev. Rul. 2005-32, page 1156.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2005. See Rev. Rul. 2005-32, page 1156.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of June 2005. See Rev. Rul. 2005-32, page 1156.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2005. See Rev. Rul. 2005-32, page 1156.

Section 832.—Insurance Company Taxable Income

26 CFR 1.832–4.— Gross income.

Insurance companies; premium stabilization reserves. This ruling holds that additions to premium stabilization reserves are return premiums for purposes of determining the amount of premiums earned on insurance contracts during a taxable year.

Rev. Rul. 2005–33

ISSUE

Are additions to a premium stabilization reserve return premiums for purposes of determining the amount of premiums earned on insurance contracts during the taxable year under § 832(b)(4)?

FACTS

IC is an insurance company other than a life insurance company, taxable under § 831(a) of the Internal Revenue Code. More than half of *IC*'s business is the issuing of insurance and annuity contracts, including group insurance contracts. Many of *IC*'s group insurance contracts are experience rated and provide for premium stabilization reserves.

IC's premium stabilization reserves are funds that it maintains under its group insurance contracts to stabilize the group policyholders' premiums over a number of years. These reserves are funded by experience rate credits on the group insurance policies. Specifically, rather than rebate amounts already included in gross premiums written to group policyholders based on experience, *IC* retains the amounts in premium stabilization reserves to pay extraordinary claims or to offset future premium increases for those policyholders. Each premium stabilization reserve arrangement is individually negotiated with the affected group policyholder. *IC* is contractually obligated to follow the formula outlined in the insurance contract for applying the premium stabilization reserve

against future increases in premiums; the operation of the premium stabilization reserves is not subject to *IC*'s experience or discretion. The premium stabilization reserves are refundable to the group policyholders in the event the related group insurance contracts are cancelled. Thus, the premium stabilization reserves are not part of *IC*'s surplus.

LAW AND ANALYSIS

Section 831(a) imposes a tax for each taxable year on the taxable income of every insurance company other than a life insurance company. Section 832(a) provides that, for this purpose, the term "taxable income" means the gross income as defined in § 832(b)(1) less the deductions allowed by § 832(c).

Section 832(b)(1) provides that the gross income of an insurance company that is subject to the tax imposed by § 831 includes the combined gross amount earned during the taxable year from investment income and from underwriting income as provided in § 832(b), computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Association of Insurance Commissioners (NAIC). Under § 832(b)(3), underwriting income consists of the premiums earned on insurance contracts during the taxable year, less losses incurred and expenses incurred.

Section 832(b)(4) provides that the amount of premiums earned on insurance contracts during the taxable year is computed by subtracting from gross premiums written any return premiums and amounts paid for reinsurance. The amount so obtained is increased by 80 percent of the unearned premiums on outstanding business at the end of the preceding taxable year, and reduced by 80 percent of the unearned premiums on outstanding business at the end of the taxable year.

Section 1.832–4(a)(6)(i) of the Income Tax Regulations provides that an insurance company's liability for return premiums includes amounts previously included in an insurance company's gross premiums written, which are refundable to a policyholder or ceding company, provided that the amounts are fixed by the insurance contract and do not depend on the experience of the insurance company or the discretion of its management.

Section 1.832–4(a)(4)(i) of the regulations provides that gross premiums written are amounts payable for insurance coverage, and that gross premiums written on an insurance contract include all amounts payable for the effective period of an insurance contract. Section 1.832–4(a)(4)(ii) enumerates specific items that must be included in gross premiums written, including amounts subtracted from a premium stabilization reserve to pay for insurance coverage.

The amounts that *IC* adds to its premium stabilization reserves with respect to group insurance contracts are return premiums within the meaning of § 1.832–4(a)(6)(i) of the regulations. The amounts were previously included in *IC*'s gross premiums written. They do not depend on the experience of *IC* or the discretion of *IC*'s management. Pursuant to formulas that are fixed in the group insurance contracts, the amounts are refundable to *IC*'s group policyholders, either to pay extraordinary claims, to offset future premium increases, or (in the event the contract is cancelled) to rebate the amounts previously paid as premiums.

Because the amounts that *IC* adds to its premium stabilization reserves are return premiums within the meaning of § 1.832–4(a)(6)(i) of the regulations, those amounts are subtracted from gross premiums written to compute premiums earned on insurance contracts under § 832(b)(4). When *IC* subtracts amounts from its premium stabilization reserves in the future to pay for insurance coverage on behalf of the same group policyholders, the amount subtracted will increase gross premiums written under § 1.832–4(a)(4)(ii)(B).

HOLDING

Additions to a premium stabilization reserve are return premiums for purposes of determining the amount of premiums earned on insurance contracts during the taxable year under § 832(b)(4).

DRAFTING INFORMATION

The principal author of this revenue ruling is Sheryl B. Flum of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue ruling, contact Sheryl B. Flum at (202) 622–3970 (not a toll-free call).

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2005. See Rev. Rul. 2005-32, page 1156.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for June 2005.

Rev. Rul. 2005–32

This revenue ruling provides various prescribed rates for federal income tax purposes for June 2005 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2005–32 TABLE 1

Applicable Federal Rates (AFR) for June 2005

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	3.46%	3.43%	3.42%	3.41%
110% AFR	3.81%	3.77%	3.75%	3.74%
120% AFR	4.16%	4.12%	4.10%	4.09%
130% AFR	4.51%	4.46%	4.44%	4.42%
Mid-Term				
AFR	4.01%	3.97%	3.95%	3.94%
110% AFR	4.42%	4.37%	4.35%	4.33%
120% AFR	4.82%	4.76%	4.73%	4.71%
130% AFR	5.23%	5.16%	5.13%	5.11%
150% AFR	6.05%	5.96%	5.92%	5.89%
175% AFR	7.07%	6.95%	6.89%	6.85%
Long-Term				
AFR	4.57%	4.52%	4.49%	4.48%
110% AFR	5.03%	4.97%	4.94%	4.92%
120% AFR	5.49%	5.42%	5.38%	5.36%
130% AFR	5.97%	5.88%	5.84%	5.81%

REV. RUL. 2005–32 TABLE 2

Adjusted AFR for June 2005

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	2.75%	2.73%	2.72%	2.71%
Mid-term adjusted AFR	3.17%	3.15%	3.14%	3.13%
Long-term adjusted AFR	4.20%	4.16%	4.14%	4.12%

REV. RUL. 2005–32 TABLE 3

Rates Under Section 382 for June 2005

Adjusted federal long-term rate for the current month	4.20%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.37%

REV. RUL. 2005–32 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for June 2005

Appropriate percentage for the 70% present value low-income housing credit	8.00%
Appropriate percentage for the 30% present value low-income housing credit	3.43%

REV. RUL. 2005–32 TABLE 5	
Rate Under Section 7520 for June 2005	
Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	4.8%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2005. See Rev. Rul. 2005-32, page 1156.

Section 1446.—Withholding Tax on Foreign Partners' Share of Effectively Connected Income

26 CFR 1.1446–1: Withholding tax on foreign partner's share of effectively connected taxable income.

T.D. 9200

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1, 301, and 602

Section 1446 Regulations; Withholding on Effectively Connected Taxable Income Allocable to Foreign Partners

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations regarding a partnership's obligation to pay withholding tax under section 1446 on effectively connected taxable income allocable under section 704 to a foreign partner. The regulations interpret the rules added to the Internal Revenue Code by section 1246(a) of the Tax Reform Act of 1986 (1986 Act), as amended by section 1012(s)(1)(A) of the Technical and Miscellaneous Revenue Act of 1988 (1988 Act), and section 7811(i)(6) of the Omnibus Budget Reconciliation Act of 1989 (1989 Act). The regulations will affect partnerships engaged in a trade or business in the United States that have one or more foreign partners. The final regulations also include conforming amendments to sections 871, 1443, 1461, 1462, 1463, 6109, and 6721. This document also contains temporary regulations under section 1446 that may apply to reduce or eliminate a partnership's obligation to pay withholding tax in certain circumstances.

DATES: *Effective Date:* May 18, 2005.

Applicability Dates: The final and temporary regulations included in this document are applicable to partnership taxable years beginning after May 18, 2005. However, a partnership may elect to apply the provisions of the final regulations to partnership taxable years beginning after December 31, 2004. Further, a partnership may elect to apply the temporary regulations to partnership taxable years beginning after December 31, 2004, provided the partnership also elects to apply the final regulations to partnership taxable years beginning after December 31, 2004.

FOR FURTHER INFORMATION CONTACT: Ronald M. Gootzeit at (202) 622–3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in the final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control numbers 1545–1852 and 1545–1934. Responses to these collections of information are required to determine the extent to which a partnership is required to pay a withholding tax with respect to a foreign partner, to 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. The estimated annual burden per respondent/recordkeeper for the collections in the final regulation varies from 15 minutes to 1 hour, depending on individual circumstances, with an estimated average of 30 minutes.

The collections of information contained in the temporary regulation have been reviewed, and pending public comment, approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1934. To comment on the collection of information in the temporary regulation, please refer to the cross-referenced NPRM (REG–108524–00) published elsewhere in this issue of the Bulletin.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information 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

On September 3, 2003, the IRS and Treasury Department published in the **Federal Register** a notice of proposed rulemaking (REG–108524–00, 2003–2 C.B. 869 [68 FR 52466]), corrected at 68 FR 62553 (November 5, 2003)) under sections 871, 1443, 1446, 1461, 1462, 1463, 6109, and 6721 of the Internal Revenue Code (Code). The regulations interpret rules added to the Code by the 1986 Act, as amended by the 1988 Act and the 1989 Act. The regulations provide guidance for partnerships required to pay withholding tax under section 1446 of the Code (1446 tax). Written comments were received in response to the notice of proposed rulemaking, and a public hearing was held on

December 4, 2003. After consideration of all the comments, the proposed regulations under sections 871, 1443, 1446, 1461, 1462, 1463, 6109, and 6721 are adopted, as revised by this Treasury Decision. The comments received and the revisions are discussed below.

In addition, this document contains temporary regulations that set forth rules to reduce or eliminate a partnership's 1446 tax obligation with respect to a foreign partner in certain circumstances. Specifically, the temporary regulations address when a partnership is permitted to consider partner-level deductions and losses when computing its 1446 tax (or any installment of such tax) with respect to a foreign partner's allocable share of partnership effectively connected taxable income (ECTI). The temporary regulations are also being issued as proposed regulations in another section of this bulletin. The temporary regulations apply to partnership taxable years beginning after May 18, 2005. However, a partnership may elect to apply the temporary regulations to partnership taxable years beginning after December 31, 2004, provided the partnership also elects to apply the final regulations to partnership taxable years beginning after December 31, 2004.

Explanation of Provisions

A. *Determining the Status and Classification of Partners—§1.1446–1*

Under §1.1446–1 of the proposed regulations, a partnership generally determines the status of its partners based upon 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 and Certification*," submitted by its partners. A partnership may also rely on other means to determine the non-foreign status of its partners, provided that the partnership's determination is correct. As described below, several commentators suggest that the final regulations permit the submission of additional forms to more closely align the section 1446 documentation requirements with the requirements under the section 1441 withholding regime.

1. *Recognition of Form W–8ECI*

Under section 6.01 of Rev. Proc. 89–31, 1989–1 C.B. 895, as modified by Rev. Proc. 92–66, 1992–2 C.B. 428, a partnership is required to include income subject to a partner's election under section 871(d) or section 882(d) (relating to the treatment of real property income as effectively connected income) in its computation of partnership ECTI when determining its 1446 tax obligation. Rev. Proc. 89–31 also provides that if a partner submits Form 4224 (predecessor form to Form W–8ECI, "*Certificate of Foreign Person's Claim for Exemption From Withholding on Income Effectively Connected With the Conduct of a Trade or Business in the United States*"), the partner's allocable share of income and gain is deemed to be effectively connected income for purposes of section 1446 (deemed ECI rule). Under the section 1441 withholding regime, a payee may provide Form W–8ECI to a withholding agent and thereby be exempt from withholding under section 1441 because the income paid is effectively connected income to the payee. Accordingly, under Rev. Proc. 89–31, a foreign partner that has made an election under section 871(d) or section 882(d) can submit Form W–8ECI to a partnership to satisfy its documentation requirements under section 1441 and section 1446.

Consistent with Rev. Proc. 89–31, the proposed regulations require a partnership to include income subject to a partner's election under section 871(d) or section 882(d) in its computation of partnership ECTI for purposes of section 1446. However, the proposed regulations do not explicitly recognize Form W–8ECI as a form establishing the status of a partner. One commentator notes that the deemed ECI rule in Rev. Proc. 89–31 is useful and provides a clear mechanism for a partnership to discharge its 1446 tax obligation. Accordingly, the commentator suggests that the final regulations recognize Form W–8ECI and the deemed ECI rule for purposes of section 1446.

Treasury and the IRS agree with the commentator's suggestion. Accordingly, the final regulations allow a partner to submit Form W–8ECI to satisfy the documentation requirements of section 1446. Thus, if a partner provides Form W–8ECI to a partnership to claim exemption from withholding under sections 1441 and 1442, then the form will be accepted for purposes of section 1446, and will operate, consistent with the information on such form, to cause the partnership to consider the partner's allocable share of income as effectively connected and subject to withholding under section 1446.

2. *Recognition of Form W–8EXP*

The proposed regulations do not recognize Form W–8EXP, "*Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding*," as a form that can establish the foreign status of a partner for purposes of section 1446. However, under the section 1441 withholding regime, for example, a foreign tax-exempt organization may submit Form W–8EXP to a payer of income to claim that the organization is a foreign tax-exempt organization that is exempt from withholding under sections 1441 and 1443(a) because the income being paid will not be includible in the organization's computation of its unrelated business taxable income (UBTI). One commentator notes that a foreign tax-exempt organization may be required to provide Form W–8EXP to a partnership for purposes of the section 1441 withholding regime, and Form W–8BEN for purposes of the section 1446 withholding regime. The same issue exists with respect to other foreign persons (*e.g.*, foreign governments) that may provide Form W–8EXP for purposes of sections 1441 through 1443. The commentator suggests that the final regulations permit a foreign tax-exempt organization (and other applicable persons) to provide Form W–8EXP to a partnership to establish the foreign status of such partner for purposes of section 1446 to eliminate the circumstances where such person has to be "double documented."

The final regulations adopt this suggestion. Treasury and the IRS believe that the documentation requirements of sections 1441 and 1446 should be coordinated where feasible. As a result, a partner seeking to be relieved from withholding under sections 1441 through 1443 that provides Form W–8EXP to a partnership, will not be required to submit an additional form

to establish foreign status for purposes of section 1446. Except with respect to certain tax-exempt organizations described in section 501(c) (see part A.5. of this preamble), the submission of a Form W–8EXP shall have no effect on whether there is a 1446 tax due with respect to such partner's allocable share of partnership ECTI. For example, a partnership must still pay 1446 tax with respect to a foreign government partner's allocable share of ECTI because such partner is treated as a foreign corporation under section 892(a)(3).

3. *Acceptable substitute form for identification of partners*

As noted above, the proposed regulations permit a partnership to use other means to ascertain the non-foreign status of its partners, provided that the partnership is correct in its determination. Further, under the proposed regulations, a partnership must generally presume that a partner that does not furnish a Form W–8BEN, Form W–8IMY, or Form W–9 is a foreign person. One commentator requests that the final regulations permit a partnership to use a substitute form to identify its partners, provided the information given to the partnership is substantially the same as that found on the above-mentioned forms.

Treasury and the IRS agree with the commentator's proposed change to the extent that the section 1441 regime would generally permit the acceptable substitute form. As a result, the final regulations adopt this comment and permit a partnership or nominee required to pay 1446 tax to develop its own form, consistent with §1.1441–1(e)(4)(vi), to serve as its substitute form upon which partners will submit information.

4. *Clarification of miscellaneous documentation issues*

Several commentators request that the final regulations clarify certain issues regarding a partnership's obligation to identify its foreign partners. One commentator requests that the final regulations address a partnership's duty, if any, to inquire as to whether a partner has made an election under section 871(d) or 882(d), or whether the partner is a dealer in securities. As described in part A.1. of this preamble, the proposed regulations provide that income subject to a partner's election under section 871(d) or 882(d) shall be considered in the partnership's computation of the partner's allocable share of partnership ECTI. Further, the proposed regulations require a partner that has made an election under section 871(d) or section 882(d) to notify the partnership that the election has been made so that the partnership can correctly determine the partner's allocable share of ECTI. The proposed regulations do not address when a partner is a dealer.

The final regulations retain the requirement that a partner notify the partnership of an election it has made (or will make) under section 871(d) or section 882(d). Further, to the extent that an election has been made, the partner is required to provide the partnership a copy of such election. However, the final regulations do not explicitly require a partner to notify the partnership that it is a dealer. Further, the final regulations do not impose an affirmative duty on the partnership to inquire as to a partner's status as a dealer or whether an election under section 871(d) or section 882(d) has been made.

Another commentator requests clarification regarding the ability of a lower-tier partnership (LTP) to use other means to identify partners of an upper-tier partnership (UTP). Under proposed regulation §1.1446–5, an LTP may be required to look through a UTP to the partners of such partnership if adequate documentation is provided to the LTP and the LTP can reliably associate (within the meaning of §1.1441–1(b)(2)(vii)) all or a portion of the UTP's allocable share of ECTI with one or more partners of the UTP. To the extent that a UTP has not provided adequate documentation as to the status of its partners to the LTP, the LTP is to treat the UTP as an entity and withhold at the highest applicable rate under section 1446(b). In this regard, the regulations cross reference proposed regulation §1.1446–1(c)(3), which allows a partnership to rely on other means to determine the non-foreign status of its partners, provided that the partnership is correct in its determination. The commentator requests clarification as to whether an LTP that has not received adequate documentation from a UTP regarding the status of one or more partners of the UTP may, nevertheless, rely on other means to determine that certain partners of the UTP are U.S. persons.

In response to the commentator's question, the final regulations remove the cross reference to §1.1446–1(c)(3). The look-through rules of §1.1446–5 are intended to be consistent with the section 1441 regulations and the concept of reliable association through documentation. Accordingly, an LTP may not rely on other means and look through a UTP to the partners of the UTP to the extent that the UTP has failed to provide adequate documentation regarding the status of its partners. Rather, to the extent the documentation submitted is insufficient to permit the LTP to look through, the LTP is to treat the UTP as a foreign entity and pay 1446 tax at the higher of the rates in section 1 or section 11.

Another commentator notes that proposed regulation §1.1446–1 provides that a foreign partnership is treated as a foreign partner under section 1446(e). The commentator then notes that §1.1446–5 of the proposed regulations provides that all or a portion of the allocable share of a UTP shall be treated as allocable to the partners of the UTP to the extent that the LTP can reliably associate the ECTI allocable to the UTP with the partners of such partnership. The effect of this rule is that for purposes of the LTP's 1446 tax computation, the UTP is not treated as the partner of the LTP. The commentator requests clarification regarding coordination of the above two sections of the proposed regulations. We note that the issue the commentator raises also arises under the proposed regulations with respect to trusts part or all of which are treated as owned by a grantor or other owner under subpart E of Subchapter J of the Code.

In response to this question, §1.1446–1 of the final regulations includes a cross reference to §1.1446–5 and language clarifying that the partners of a UTP are considered the direct partners of an LTP only to the extent the LTP is applying the look through rules of §1.1446–5 in computing its 1446 tax obligation. This treatment is only for purposes of computing the LTP's 1446 tax liability and has no effect on LTP's reporting. Thus, whether or not an LTP computes its 1446 tax by looking through a UTP, the LTP shall furnish Form 8805 with respect to the 1446 tax it pays to and in the name of the UTP so that such UTP may then, in turn, take such amounts into account in computing its 1446 tax

obligation. UTP will then claim a credit for the 1446 tax LTP paid and will allocate the credit to its partners (or claim a refund), as appropriate, and report the allocation of the tax on the Forms 8805 it furnishes to its foreign partners. Similarly, the final regulations clarify that a grantor or other owner under subpart E of subchapter J of the Code of a domestic or foreign trust is the beneficial owner of income and it (rather than the trust) is considered the partner only for purposes of computing the partnership's 1446 tax liability.

5. *Coordination with section 1443 and foreign tax-exempt organizations*

Section 1443(a) provides that withholding under chapter 3 of the Code shall apply to income includible under section 512 in computing the UBTI of a foreign organization subject to the tax imposed by section 511 only to the extent and subject to such conditions as may be provided by regulations. The proposed regulations provide that if an amount is allocable from a partnership to an entity described in section 1443(a), then the partnership must withhold under section 1446. One commentator notes that section 1443(a) only applies to the extent that an item of income is includible in the computation of UBTI, and that the proposed regulations fail to recognize that some income items comprising part of the partnership's ECTI will not be includible by a partner in computing its UBTI. See §§1.512(b)–1 and 1.512(c)–1. Further, the commentator notes that in the context of section 1441, section 1443(a) is enforced by a presumption contained in §1.1441–9(b)(3) that income will be includible in computing a foreign tax-exempt organization's UBTI if the documentation the payee provides is unreliable or is lacking, and that the final regulations should include a similar presumption in the case of section 1446 with respect to foreign tax-exempt partners.

In response to the commentator's suggestions, the final regulations clarify that only the portion of a tax-exempt partner's allocable share of partnership ECTI that is includible in the partner's computation of UBTI is subject to section 1446. The final regulations also provide that the procedures in §1.1441–9 for claiming an exemption from withholding under section 1441 will apply for claiming an exemption from withholding under section 1446. Under those procedures, the organization may specify the portion of its allocable share of partnership income that will not be includible in the organization's computation of its UBTI. Thereafter, the partnership may determine that a partner's representation as to amounts not includible in the organization's UBTI is unreliable or lacking. If such a determination is made, the partnership must then presume, consistent with §1.1441–9(b)(3) as applied for purposes of section 1446, that the partnership item will be includible in computing the partner's UBTI.

In response to another comment, the language of the final regulations has been changed to follow more closely the language of section 1443(a) and the regulations thereunder.

6. *Corresponding changes to forms*

The IRS intends to modify several forms (*e.g.*, Forms W–8, 8804, 8805, 8813) to accommodate the adoption of the final and temporary regulations set forth in this document. Until such time as the forms are modified, partners, nominees, and partnerships may use the current version of a form and attach a statement to such form, to the extent necessary, to explain the use of the form for purposes of section 1446.

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

1. *Cancellation of indebtedness income and gain from foreclosure and deed in lieu of foreclosure*

The proposed regulations requested comments on the appropriate treatment under section 1446 of partnership cancellation of indebtedness income (COD). Several comments, discussed below, were received.

One commentator suggests that a partnership should be relieved of its 1446 tax obligation with respect to COD income allocable to foreign partners provided the partnership files with the IRS an explanatory statement that substantiates its financial hardship. A second commentator cites the rules set forth in §1.1445–2(d)(3), applicable to a foreclosure that results in a disposition of a United States real property interest. Consistent with §1.1445–2(d)(3), the commentator proposes that so long as the partnership receives no cash or other property as part of the cancellation of indebtedness or the foreclosure on property (or deed in lieu of foreclosure), income attributable to such amounts should be excluded from partnership ECTI and the partnership should not be required to withhold on such amounts. However, the commentator states that to the extent that the partnership makes a distribution within the same taxable year that the COD income or gain arising from a foreclosure (or deed in lieu of foreclosure) is realized, the partnership ECTI for the year of realization should include the COD income or gain from foreclosure up to the amount of the distribution. Finally, one commentator focuses on a partnership in a Chapter 11 bankruptcy proceeding and cites a potential conflict between the deemed distribution rule of section 1446(d) and the prohibition on preferential treatment of non-creditors found in the Bankruptcy Code. This commentator recommends that a partnership in a Chapter 11 bankruptcy proceeding that incurs COD income should be relieved from paying 1446 tax on such income.

Treasury and the IRS believe that section 1446 requires a partnership to pay 1446 tax on COD income and gain recognized by reason of a foreclosure or deed in lieu of foreclosure on property when such income or gain is allocated to foreign partners. The purpose of the statute is to collect taxes that foreign persons may not otherwise pay, regardless of the liquidity or financial situation of the withholding agent. Further, unlike section 1441, section 1446 does not require that a partnership have control, receipt, custody, disposal, or payment over the income that is subject to withholding. As a result, no exception is mandated. In addition, Treasury and the IRS do not believe that a deemed distribution under section 1446(d) would violate any provisions of the Bankruptcy Code. Accordingly, the final regulations do not adopt the commentators' suggestions regarding COD income or gain arising from the foreclosure (or deed in lieu of foreclosure) on property. However, Treasury and the IRS are issuing temporary and proposed regulations that permit a foreign partner, in certain circumstances, to certify to the partnership that it has deductions and

losses it reasonably expects to be available to reduce the partner's U.S. income tax liability on the partner's allocable share of effectively connected income or gain from the partnership. This certification procedure may apply to reduce the partnership's 1446 tax obligation with respect to COD income allocable to a foreign partner in appropriate circumstances. Treasury and the IRS believe that this approach, which is consistent with the statute and legislative history, appropriately balances the interests of taxpayers and the government.

2. *Consideration of a foreign partner's deductions and losses in computing the partner's share of partnership ECTI.*

See §1.1446–6T and part G. of this preamble regarding when a partnership may consider partner-level deductions and losses in determining its 1446 tax due with respect to a partner.

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

1. *Applicable percentage for computing 1446 tax*

The proposed regulations require a partnership to pay withholding tax (1446 tax) using the highest rate of tax specified in section 1 (with respect to ECTI allocable to a non-corporate foreign partner) or section 11(b)(1) (with respect to ECTI allocable to a corporate foreign partner). Several commentators note that the proposed regulations effectively require a partnership to pay 1446 tax in excess of a partner's actual tax liability because the partnership is not permitted to consider preferential tax rates that apply to long-term capital gain or other special items of income or gain at the partner-level (*e.g.*, unrecaptured section 1250 gain). The commentators note that at the time that Congress enacted and amended section 1446 there was no difference between the tax rate for capital gains and ordinary income and, therefore, section 1446 should not be read to prohibit consideration of the highest rate that may apply to special items of income or gain. The commentators request that the final regulations permit a partnership to consider the character of income or gain allocable to a foreign partner and pay 1446 tax at the highest rate applicable to the type of income or gain allocable to a foreign partner.

Treasury and the IRS have carefully considered these comments and generally believe that permitting a partnership to consider the highest rate of tax associated with particular partnership items of income and gain is a reasonable approach under the statute that would reduce the instances of overwithholding without undermining the purpose or effectiveness of the statute. In response, the final regulations provide that while a partnership is generally required to use the highest rate of tax in section 1 or section 11 (currently 35 percent) applicable to a partner, it may also consider (subject to exceptions discussed below) the type of income or gain allocable to a foreign partner during the taxable year when computing its 1446 tax obligation. As a result, a partnership can generally pay 1446 tax using the highest capital gains rate (currently 15 percent) to the extent long-term capital gain is allocable to a non-corporate foreign partner. Similarly, the highest rate of tax for collectibles gain under section 1(h)(6) (currently 28 percent) may generally be considered when such gain is allocable to a non-corporate foreign partner. Further, a partnership can generally pay 1446 tax using the maximum tax rate for unrecaptured section 1250 gain (currently 25 percent) to the extent such gain is allocable to a non-corporate foreign partner. When applicable, the partnership must use the highest preferential rate for a particular type of income or gain without regard to the amount of the foreign partner's allocable share of such income or gain, or the foreign partner's other income.

As discussed above, several preferential rates depend upon the status of the person (corporate or non-corporate) allocated the income or gain (*e.g.*, long-term capital gain). Further, in some circumstances under the final regulations documentation may be lacking as to the corporate or non-corporate status of a partner. Accordingly, the final regulations include a rule that prohibits a partnership from using a preferential rate in computing its 1446 tax on income or gain allocable to a foreign partner where the preferential rate depends upon the corporate or non-corporate status of the partner and either such status has not been established by documentation or the regulations otherwise instruct the partnership to pay 1446 tax at the higher of the applicable rates in section 1446(b).

For example, under §1.1446–1(c)(3) a partnership that has not received documentation from a partner must presume that the partner is a foreign person, unless the partnership relies on other means to determine the non-foreign status of the partner. Further, the regulations instruct that if the partnership knows that the partner is an individual, then the partnership must pay 1446 tax using the applicable percentage appropriate for a non-corporate foreign partner (highest rate in section 1). Notwithstanding the foregoing, under the rule in the final regulations, the partnership may not consider the preferential rate applicable to any net long-term capital gain allocable to such partner because the preferential rate applicable to that type of gain depends on the status of the person reporting such gain, and the partner has failed to provide documentation in accordance with §1.1446–1.

Similarly, under §1.1446–5 a partnership may not be able to reliably associate 100 percent of an upper-tier partnership's allocable share of ECTI with the partners of the upper-tier partnership. In such circumstances, §1.1446–5(c)(2) requires the lower-tier partnership to pay 1446 tax on the portion it cannot reliably associate with partners of the upper-tier partnership at the higher of the rates in section 1446(b). Even though the upper-tier partnership has provided documentation on its own behalf (*e.g.*, Form W–8IMY), and the lower-tier partnership therefore knows that the upper-tier partnership is a non-corporate entity, the lower-tier partnership may not consider any preferential rate when computing its 1446 tax due on the portion of the ECTI the lower-tier partnership cannot reliably associate with partners of the upper-tier partnership.

2. *Deemed cash distributions under section 1446(d)*

Section 1446(d) states that, except as provided in regulations, a partnership's payment of 1446 tax with respect to a foreign partner is treated as a distribution to the partner on the earlier of the day the partnership paid the tax or the last day of the partnership's taxable year for which such tax was paid. The legislative history provides that the above rule may

be altered by regulations to account for mid-year dispositions of partnership interests. See H.R. Rep., 101–247, 101st Cong., 1st Sess. (Sept. 20, 1989). Under Rev. Proc. 89–31, 1989–1 C.B. 895, if the 1446 tax is paid in a subsequent taxable year with respect to ECTI allocable to the preceding taxable year, the deemed distribution is considered to have occurred on the last day of the preceding taxable year or the last day during such year that the person was a partner. The proposed regulations follow the rules outlined above.

Several commentators note that the deemed distribution under section 1446(d) may cause a partner to recognize gain under sections 731 and 741. Under section 731, a partner recognizes gain on a partnership distribution only to the extent the partner receives cash in excess of its basis in the partnership. To the extent a partner receives cash in excess of the partner's basis in its partnership interest, section 731 considers the partner to have engaged in a sale or exchange of the interest, the tax consequences of which are described in section 741. Under section 1446(d), if the partnership is deemed to distribute cash during the taxable year (*i.e.*, on the date the 1446 tax is paid), before the date that the partner may consider an increase in the partner's basis in the partnership under section 705 for income allocable from the partnership for the entire taxable year, then the partner may recognize gain under sections 731 and 741.

One commentator proposes that, for purposes of section 1446(d), a partnership should look to the partnership agreement to determine whether a distribution under section 1446(d) has occurred. Specifically, the commentator states that a partnership should not treat a payment of 1446 tax on behalf of a foreign partner as a deemed distribution under section 1446(d) to the extent the partnership agreement prohibits a distribution to the partner, or the partner is required to pay back to the partnership part or all of the 1446 tax paid on the partner's behalf. The commentator suggests that the regulations should consider both explicit provisions of the partnership agreement that require a foreign partner to contribute to the partnership an amount equal to the 1446 tax the partnership paid on behalf of the partner and provisions that have the effect of requiring a contribution, though not explicitly referring to section 1446.

Another commentator suggests that a deemed distribution under section 1446(d) that results from a partnership's installment payment of 1446 tax should be considered an advance or drawing against a partner's distributive share of income within the meaning of §1.731–1(a)(1)(ii) and treated as a current distribution made on the last day of the partnership taxable year with respect to such partner. Adopting this suggestion would reduce the likelihood of a foreign partner recognizing gain because the deemed distribution would be measured against the partner's basis in its partnership interest after the partner's basis has been increased for income allocable to the partner for the partnership's taxable year under section 705.

A third commentator notes a conflict with the deemed distribution rule in the context of a partnership in bankruptcy. See discussion at Part B.1. of this preamble.

Treasury and the IRS believe that deemed distributions under section 1446(d) should not unnecessarily result in a foreign partner having to recognize gain under sections 731 and 741, and that the deemed distributions should be treated consistently with other distributions under subchapter K. Further, section 1446(d) provides Treasury and the IRS with explicit authority to alter the rules to accomplish the objectives of the section. Accordingly, the final regulations generally provide that a deemed distribution under section 1446(d) is treated as an advance or drawing within the meaning of §1.731–1(a)(1)(ii) against the partner's distributive share of income from the partnership. See also Rev. Rul. 94–4, 1994–1 C.B. 195. As a result, the tax ramifications of a partnership's payment of 1446 tax on a foreign partner's allocable share of ECTI will be considered by the partner at the end of the partnership's taxable year, or the last day of the partnership's taxable year during which such person was a partner in the partnership. The advance or drawing treatment applies only to installment payments of 1446 tax made during the partnership's taxable year with respect to ECTI earned in the same taxable year. Any 1446 tax paid after the close of the partnership's taxable year, including amounts paid with the filing of Form 8804, "*Annual Return for Partnership Withholding Tax (Section 1446)*," that are on account of partnership ECTI allocated to partners for the prior taxable year shall be treated under section 1446(d) and the regulations as a distribution from the partnership on the earlier of the last day of the partnership's prior taxable year for which the tax is paid, or the last day in such prior taxable year on which such foreign partner held an interest in the partnership. The rules in the final regulations apply only for purposes of determining the tax ramifications of the deemed distribution to a foreign partner under sections 705, 731, and 733, and do not affect the date that the partnership (or partner) is otherwise considered (or deemed) to have paid tax for purposes of section 6654 and section 6655.

The final regulations do not adopt the suggestion that a deemed distribution under section 1446(d) should occur only to the extent the partnership agreement permits a distribution to the foreign partner and does not require the foreign partner to contribute an amount to the partnership. Treasury and the IRS believe that the suggestion is inconsistent with section 1446(d) and the treatment of distributions under subchapter K of the Code. To the extent that 1446 tax has been paid on behalf of a partner and a Form 8805 has been issued to a partner, section 1446(d) requires that such amount be treated as a distribution. Further, such an approach would not be administrable because it would require the IRS to review each partnership agreement and interpret the provisions of the agreement for purposes of section 1446. Moreover, Treasury and the IRS are concerned that the suggested approach would inappropriately result in different treatment for similarly situated foreign partners.

3. *Overlap between section 1445 and 1446*

The proposed regulations provide that when section 1445 and section 1446 both technically apply, a partnership is required to pay withholding tax on behalf of its foreign partners in accordance with section 1446. This rule, referred to as the trumping rule, primarily relates to a domestic partnership's disposition of a United States real property interest within the meaning of section 897, which is subject to withholding under section 1445(e)(1). The

proposed regulations also permit a foreign partnership to credit the amount withheld by a transferee under section 1445(a) when computing its 1446 tax obligation.

Several commentators note that the trumping rule has the effect of prohibiting a partnership and/or its partners from seeking a certificate from the IRS, where appropriate, that would reduce withholding to an amount more closely related to a partner's actual tax liability on the gain allocated. See Rev. Proc. 2000–35, 2000–2 C.B. 211, §8.01. As a result, several commentators suggest that the final regulations remove the trumping rule and modify the section 1445 withholding certificate program so that partnerships and partners subject to section 1446 can consider anticipated current year deductions and losses and obtain withholding certificates to reduce the withholding tax otherwise required to be paid. In addition, one commentator requests clarification of the consequences for failure to comply with section 1446 under the trumping rule.

After consideration of the comments described above, the trumping rule is retained in the final regulations. Treasury and the IRS do not believe Congress intended for section 1445 to apply to the exclusion of section 1446 where the sections overlap. Treasury and the IRS believe that with the changes made in the final regulations (*e.g.*, consideration of the character of income allocable to a foreign partner, see part C.1. of this preamble) and the issuance of the temporary regulations that permit foreign partners to certify available deductions and losses to a partnership, the section 1446 withholding regime will, in most circumstances, arrive at a withholding result that approximates the result that would otherwise be reached under section 1445. The final regulations clarify that a partnership that fails to comply with section 1446 under the rule described above may be subject to all additions to the tax, interest, and penalties that otherwise apply to a failure to pay 1446 tax.

4. *Notice to foreign partners of 1446 tax paid by partnership*

The proposed regulations require a partnership that pays 1446 tax on behalf of a foreign partner to notify the partner when a payment of tax has been made. Because the 1446 tax installment due dates are the 15th day of the 4th, 6th, 9th, and 12th months of the partnership's taxable year, a partnership must generally notify a foreign partner four times during the taxable year of the 1446 tax paid on the partner's behalf. The notice provided during the taxable year of the 1446 tax paid is not required to be in any particular form but must contain, among other items, information sufficient to identify the partnership, the partner, the annualized amount of ECTI estimated to be allocated to the partner, and the amount of 1446 tax paid to the IRS on behalf of the foreign partner.

After the close of the partnership taxable year, the partnership is required to file Forms 8804 and 8805 with the IRS and to provide a Form 8805 to each foreign partner. The Form 8805 furnished to a foreign partner will set forth the 1446 tax paid on the partner's behalf for the entire taxable year. Each foreign partner receiving a Form 8805 from the partnership is generally permitted to claim a tax credit under section 33 on its U.S. Federal income tax return in the amount shown on the form as paid on the partner's behalf. When completing its Form 8804 and Form 8805, the partnership will use the actual results of the partnership's operations for the previous year. When completing its Form 8804, if the partnership determines that its 1446 tax is an amount greater than previously estimated, the partnership is required to pay any shortfall when filing the form.

One commentator submits that it is administratively burdensome and costly to require a partnership to notify its foreign partners four times during the year when each installment of 1446 tax is paid on their behalf. The commentator also contends that it is burdensome on a partnership to have to explain to each foreign partner any discrepancy between the four notices provided during the taxable year, which are based on estimates, and the Form 8805 issued after the close of the taxable year, which is based on the partnership's actual operating results. Finally, the commentator contends that it is burdensome, costly, and inefficient in large non-publicly traded partnerships, where the net income to be allocated to a partner is often small, to have to provide notice to thousands of foreign partners four times during the taxable year and again after the taxable year.

A second commentator makes two points concerning the requirement that a partnership provide notice during the taxable year for each 1446 tax installment payment. First, the commentator suggests that because the section 1446 tax rate is the highest rate applicable to a foreign partner, most foreign partners do not need notice during the taxable year because they already assume the partnership's 1446 tax installment payments will exceed any estimated tax they might otherwise owe on their allocable share of ECTI. Second, the commentator submits that in practice the notices are often not received before a foreign partner's estimated tax due date for the same period and, therefore, provide little or no benefit to the foreign partner.

Both commentators propose that unless a foreign partner requests information for each installment payment of 1446 tax, a partnership should only be required to report to the foreign partner the amounts paid to the IRS on behalf of the partner after the close of the taxable year on Form 8805.

Treasury and the IRS believe that the notice requirement in the proposed regulations serves the useful function of advising a foreign partner of amounts paid on its behalf. The notice may aid a partner in computing its estimated tax liability either for the same installment period or a subsequent installment period during the taxable year. This is particularly true where the estimated tax payment dates of the foreign partner do not coincide with the 1446 tax installment dates. See section 6654(j). Based upon the foregoing, the final regulations retain the notice requirement set forth in the proposed regulations.

However, Treasury and the IRS recognize that situations may exist where the notice requirement is particularly burdensome. Accordingly, the final regulations contain two exceptions to the requirement that the partnership provide notice during its taxable year as it pays each installment of 1446 tax. First, where an agent of the partnership charged with providing notice to the foreign partners of the partnership during the taxable year for each installment of 1446 tax is the same person that also acts as an agent on behalf of a foreign partner for purposes of filing the foreign partner's U.S. income tax return, the notice requirement is deemed to be satisfied with respect to such partner. Second, a partnership with 500 or more foreign partners is not required to provide notice to a foreign partner of amounts paid

on such partner's behalf during the course of the taxable year, unless requested, if the partnership estimates that the 1446 tax on such partner's allocable share of partnership ECTI is less than $1,000. If one of the exceptions applies to a foreign partner for an installment payment of 1446 tax, then the partnership is not required to provide notice of the installment payment (and the tax paid on the partner's behalf) unless requested by the partner. However, in all events, the partnership is required to provide notice of the tax paid on the partner's behalf after the close of the taxable year by issuing Form 8805 to the partner.

5. *Refunds by partnership for amounts withheld*

Under the proposed regulations, a partnership is entitled to obtain a refund for 1446 tax paid over to the IRS only if a refund is permissible under section 1464 and the regulations thereunder. The position in the proposed regulations varies from the position in Rev. Proc. 92–66, which permits a partnership to obtain a refund of 1446 tax to the extent an amount paid to the IRS is not reflected on a Form 8805 issued to a partner for the taxable year. One commentator notes that because actual operating results can vary significantly from the estimates the partnership uses during the year to calculate its 1446 tax, withholding in excess of the partner's actual tax liability can occur. That is, where a partnership annualizes its income under one of the accepted methods but events occur that are not taken into account until the partnership files its Form 8804, and such events have the effect of reducing or eliminating the 1446 tax otherwise due, the partnership should be entitled to a refund of the overpaid amounts. The commentator proposes that the final regulations adopt the refund system set forth in Rev. Proc. 92–66.

In response to the commentator's suggestion, the final regulations adopt the position taken in Rev. Proc. 92–66 with respect to refunds to withholding agents, thereby permitting non-publicly traded partnerships subject to section 1446 to obtain refunds for 1446 tax paid to the IRS to the extent that the amounts are not reflected on a Form 8805 issued to a partner. Publicly traded partnerships (and nominees) required to pay 1446 tax based on distributions of effectively connected income will continue to be subject to section 1464 and the regulations thereunder. The standard in the regulation is intended to follow the approach set forth in Rev. Proc. 92–66 in all respects.

6. *Additions to the tax, interest and penalties for noncompliance with section 1446*

i. *In General*

The proposed regulations provide that if a partnership fails to file and pay its 1446 tax, but a partner files a U.S. Federal income tax return for the taxable year and pays all tax required to be shown on that return, then the partnership is deemed to have filed Forms 8804 and 8805 and paid its 1446 tax with respect to such foreign partner as of the date that the partner satisfied the aforementioned conditions. Therefore, the proposed regulations contain a deemed filing and payment rule applicable to a partnership that is based upon a foreign partner completing two actions: 1) filing its U.S. Federal income tax return, and 2) paying all tax required to be shown on such return. Treasury and the IRS have modified the deemed filing and payment rules in the final regulations to better coordinate section 1446 with section 1463, as well as with any additions to the tax, interest, and penalties that may apply.

First, the final regulations modify the rule in the proposed regulations that deems a partnership to have paid 1446 tax with respect to a partner. As modified, the final regulations make a partnership's deemed payment dependent only on the partner's payment of all the tax the partner is required to pay, and disregard the partner's actual filing of a U.S. Federal income tax return. As modified, the deemed payment rule is consistent with general principles of when a tax is considered paid.

Second, the final regulations remove the deemed filing rule in the proposed regulations because of the administrative difficulties in such cases where there are multiple foreign partners. Therefore, under the final regulations, a partnership will not be deemed to have filed Forms 8804 and 8805 at any time. As a result, once the failure to file penalty under section 6651(a)(1) begins to accrue, as discussed below, a partnership may affirmatively stop the accrual of the penalty only by filing Form 8804.

Third, the final regulations clarify the date upon which a partnership will be deemed to have paid 1446 tax under the deemed payment rule. The rule applies for purposes of sections 1446, 1461, 1463, 6601, 6651, 6655, and any other penalties or additions to the tax that may apply. The rule provides that a partnership will be deemed to have paid the 1446 tax associated with ECTI allocable to a particular partner on the later of the date that the partner is considered to have paid all its tax under section 6513(a) and (b)(2) (prescribing the date tax is considered paid for purposes of sections 6511(b)(2), (c), and 6512), or the last date for paying the 1446 tax without extensions (the unextended due date for Form 8804). In application, the rule ensures that a partner's payments of estimated tax will have no effect on the computation of the partnership's underpayment addition to the tax under section 6655 and §1.1446–3 of the regulations.

Fourth, the final regulations change the method required for a partnership to show that a partner has paid all tax required to be shown on the partner's U.S. Federal income tax return. In response to one commentator, the final regulations adopt the method set forth in §1.1445–1(e)(3) because such method is more familiar and easier for partnerships to apply than obtaining Form 4669, "*Statement of Payments Received*," the method set forth in the proposed regulations. Under the final regulations, a partnership must provide sufficient information for the IRS to determine that the partner's tax liability was satisfied or established to be zero.

More specific discussion of various additions to the tax, interest, and penalties is provided below.

ii. *Current Year Safe Harbor Under Section 6655 and §1.1446–3*

Section 1446 imposes a withholding regime that applies the principles of section 6655, as modified by these regulations. Under section 6655, a corporation is not liable for an underpayment addition to the tax if the corporation pays 25 percent of either the preceding year's or the current year's tax liability in each quarterly installment. These safe harbors are often referred to as the prior year safe harbor and

the current year safe harbor. The proposed regulations provide for a modification of the prior year safe harbor that is consistent with Rev. Proc. 89–31, but do not mention the potential application of the current year safe harbor. The final regulations clarify that the current year safe harbor of section 6655(d)(1)(B)(i) can apply to a partnership subject to section 1446. Further, the final regulations retain the language in the proposed regulations that sets forth the prior year safe harbor.

iii. *Accrual of Addition to the Tax Under Section 6655, Interest Under Section 6601, and Penalties*

One commentator requests clarification regarding the accrual of the addition to the tax under section 6655, interest under section 6601, and penalties under the proposed regulations. Specifically, the commentator requests that the final regulations clarify whether a partnership's deemed payment of 1446 tax under proposed regulation §1.1446–3(e)(2) will stop the accrual of the addition to the tax, interest, and penalties that may be applicable under proposed regulation §1.1446–3(e)(3) or other sections of the regulations. The commentator requests that the final regulations address the accrual of the addition to the tax, interest and penalties, and explicitly provide that such additions, penalties and interest will stop accruing on the date the partnership's liability is deemed paid.

The final regulations do not explicitly address the accrual of all of the potential penalties that may apply to a partnership required to pay 1446 tax, but do include provisions and examples that illustrate the application of sections 6655 (relating to the addition to the tax for an underpayment of an installment of 1446 tax), 6601 (relating to interest), and 6651 (relating to failure to file and failure to pay penalties).

Regarding the addition to the tax under section 6655, the final regulations provide that the addition to the tax will begin to accrue on the date that the partnership underpays an installment of 1446 tax and will stop accruing on the earlier of the date when all the 1446 tax is satisfied, or the 15th day of the 4th month following the close of the partnership's taxable year (15th day of the 6th month in the case of a partnership keeping its books and records outside the United States and Puerto Rico).

As discussed in part C.6.i. of this preamble, the final regulations provide that a partner's payment of tax that deems a partnership to have paid 1446 tax will not be credited to the partnership's account until the later of the date that the tax is considered to have been paid by the partner under section 6513(a) and (b)(2) (prescribing the date tax is considered paid for purposes of sections 6511(b)(2), (c), and 6512), or the last date for paying 1446 tax without extensions (*i.e.*, the unextended due date for Form 8804). Under this "later of" rule, the earliest that a partner's payments can be credited to the partnership is the last date for paying the 1446 tax without extensions (the unextended due date for Form 8804), the date that the accrual of the section 6655 addition to the tax would stop in any event. As a result, a partner's payments of estimated tax will not provide a partnership with any benefit with respect to the partnership's computation of the underpayment addition to the tax under section 6655, as applied in the regulations.

Regarding interest under section 6601, if a partnership's 1446 liability has not been satisfied, or deemed satisfied, by the last date prescribed for payment of the 1446 tax under section 1461 without extensions (see section 6601(b)(1)), then interest under section 6601 will begin to accrue on the unpaid 1446 tax liability. The final regulations provide that interest will stop accruing on the date and to the extent that the partnership actually pays the 1446 tax or is deemed to have paid the 1446 tax under the deemed payment rule in the regulations.

Section 6651(a)(1) generally applies to the failure to file any tax return by the due date (including extensions) prescribed therefore and applies in the context of section 1446 to a failure to file Form 8804. The penalty accrues at 5 percent of the amount of the tax that is required to be shown on the return for each month or fraction of a month during which the required return is not filed but not exceeding, in the aggregate, 25 percent of the amount required to be shown as tax on the return. Similarly, under section 6651(a)(2), for each month after the date prescribed for payment that a taxpayer fails to pay the amount shown as tax on any return, there is added to the amount shown as tax 0.5 percent of such tax not to exceed 25 percent in the aggregate. While section 6651(a)(1) applies upon a failure to file a return, and section 6651(a)(2) only applies if a return has been filed, there are circumstances where both penalties can apply. See 6651(c). Both penalties provide an exception if it is shown that such failure is due to reasonable cause and not due to willful neglect.

Under the deemed payment rule of the final regulations, discussed above, a partnership that fails to pay 1446 tax with respect to a foreign partner will be deemed to have paid the 1446 tax associated with the ECTI allocable to such foreign partner on the later of the date that such partner is considered to have paid its U.S. income tax under section 6513(a) and (b)(2), or the last date for payment of the 1446 tax without extensions. Section 6651(b)(1) reduces the base upon which the section 6651(a)(1) penalty is computed (the amount required to be shown as tax on the return) by the partnership's actual and deemed payment of tax, provided the actual or deemed payment occurs on or before the date prescribed for payment of the tax. To the extent the partnership has not paid (or been deemed to have paid) all 1446 tax due with respect to a partner as of the date prescribed for payment of the tax, the failure to file penalty under section 6651(a)(1) will begin to accrue on the Form 8804 filing due date and will continue to accrue until the earlier of the date that Form 8804 is actually filed, or the date that the maximum monthly accrual has occurred under the section; *i.e.*, five months. Stated differently, if a partnership fails to file Form 8804 and the 1446 tax has not been paid or deemed paid by the date prescribed for payment of the tax, the failure to file penalty will begin to accrue and may only be stopped by the partnership filing such form or the statutory limit of the penalty being reached; payment of the 1446 tax (actual or deemed) after the date prescribed for payment of the tax, without actually filing Form 8804, will not stop the accrual of the penalty.

A similar analysis applies to the accrual of the failure to pay penalty under section 6651(a)(2). However, the failure to pay penalty cannot be imposed unless Form 8804 is filed and the accrual of the penalty can be stopped by paying the 1446 tax. Once Form 8804 is filed, the penalty accrues at a rate of 0.5 percent of the amount of the unpaid 1446 tax beginning on the

due date for payment of such tax (with regard to extensions), regardless of when the form was filed, and continues to accrue each month on the unpaid 1446 tax until the earlier of the date the 1446 tax is completely paid, deemed paid, or the maximum monthly accrual of 25 percent in the aggregate is reached. The time at which a partnership is deemed to have paid 1446 tax for purposes of sections 1446, 1461, 1463, 6601, 6651, and 6655 is discussed above.

7. *Application of de-minimis rule of section 6655(f)*

The proposed regulations state that the principles of section 6655 shall apply to a partnership computing its 1446 tax. Section 6655(f) provides that a corporation is not required to pay estimated tax when the amount of such tax is less than $500. However, the proposed regulations under section 1446 do not address the application of the principles of section 6655(f) in the context of section 1446.

One commentator proposes that a partnership with more than 100 nonresident alien partners should not be required to pay 1446 tax (or any installment of such tax) on behalf of a nonresident alien partner if the estimated ECTI allocable to the nonresident alien partner does not exceed the annual personal exemption provided to such partner under section 151 of the Internal Revenue Code. The commentator states that the administrative costs associated with the payment of 1446 tax for such partners is burdensome when considered in light of the fact that these foreign partners are often entitled to refunds of such amounts. Further, the commentator suggests that these nonresident alien partners, who otherwise have no presence in the United States, often have difficulty in securing refunds and, as a result, are discouraged from seeking such refunds because of the small dollar amounts involved.

The final regulations describe the application of the principles of section 6655(f) for purposes of section 1446. The final regulations provide that a partnership shall apply the principles of section 6655(f) by taking into account all foreign partners. That is, the partnership must compare its total 1446 tax liability for all foreign partners to the $500 threshold in section 6655(f). However, Treasury and the IRS believe that the section 1446 regime should operate so that it does not discourage investment in the United States by imposing administrative costs on partnerships that are unrelated to insuring that the appropriate amount of tax is collected. Consequently, the temporary regulations contain an exception to this rule that applies in certain circumstances. See part G.9. of this preamble, below.

8. *Application of section 6655(i)*

The proposed regulations under section 1446 state that the principles of section 6655 shall apply to a partnership required to pay 1446 tax. Section 6655(i)(2) provides that section 6655 shall apply to taxable years of less than 12 months in accordance with regulations prescribed by the Secretary. However, the proposed regulations under section 1446 do not address the application of the principles of section 6655(i)(2).

The final regulations provide that even if a partnership has a taxable year of less than 12 months, the partnership is required to pay 1446 tax (including installments of such tax) if the partnership has ECTI allocable to foreign partners. In such a case, the partnership shall adjust its installment payments of 1446 tax in a reasonable manner (*e.g.*, the annualized amounts of ECTI estimated to be allocable to a foreign partner, and the percentage of tax to be paid with each installment) to account for the short taxable year. However, if the partnership's taxable year is a period of less than four months, the partnership shall only be required to file Form 8804 in accordance with the regulations and report and pay the appropriate 1446 tax for the short taxable year.

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

1. *Background*

The proposed regulations contain several rules applicable to domestic and foreign trusts and estates. First, the proposed regulations require that a domestic grantor trust provide a statement to the partnership that it is a grantor trust and also provide documentation (*e.g.*, Form W–8BEN, Form W–9) of the grantor or other owner of the trust. A foreign grantor trust must provide Form W–8IMY to the partnership along with documentation of the grantor or other owner of the trust. In both of these situations, the partnership computes its 1446 tax based on the status of the grantor or other owner, rather than the trust, to the extent of such grantor or other owner's interest. All other trusts are required to provide Form W–8BEN or Form W–9, as appropriate, to the partnership on their own behalf.

Second, the proposed regulations require a foreign non-grantor trust (including an estate) to allocate the 1446 tax paid by the partnership with respect to the trust or estate's allocable share of ECTI between the trust or estate and its beneficiaries. This allocation is based upon the taxpayer (trust/estate or beneficiary) that will ultimately report and pay tax on the ECTI allocable from the partnership. The rule is designed to match the tax credit under section 33 for the 1446 tax the partnership paid with the taxpayer that is ultimately responsible for bearing the income tax liability on the net income allocated from the partnership.

Third, the proposed regulations contain a rule to backstop the rule described in the previous paragraph. This so-called domestic trust rule provides that 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 non-grantor trust, or possibly other entities, and such trust was formed or availed of with a principal purpose of avoiding the 1446 tax, then such domestic trust will be treated as a foreign trust and the rule described in the previous paragraph with respect to the allocation of the credit for 1446 tax paid will apply. When applicable, this rule permits the IRS to impose the 1446 tax obligation on a partnership as if each domestic trust in the chain is a foreign trust. Several comments, discussed below, were received regarding the trust rules in the proposed regulations.

2. *Documentation requirement for domestic grantor trusts*

One commentator notes a difference in the documentation requirements for domestic grantor trusts under sections 1441 and 1446. The commentator states that under section 1441, a domestic grantor trust can provide Form W–9 to the withholding agent in its own right, but under sec-

tion 1446, the domestic grantor trust must provide the partnership a statement that it is a grantor trust and include the documentation of the grantor or other owner (*e.g.*, Form W–8BEN). The commentator suggests that the final regulations eliminate this difference and allow a domestic grantor trust to provide Form W–9 in its own right for purposes of section 1446, just as the trust is entitled to do under section 1441.

The final regulations do not adopt this suggestion. Treasury and the IRS believe that it is appropriate for a partnership to compute its 1446 tax liability with respect to a grantor or other owner of a trust rather than the trust itself because it is the grantor or other owner that is responsible for reporting the ECTI on its U.S. income tax return and paying tax with respect to the income. Further, unlike section 1441, the withholding obligation under section 1446 applies only to partnerships rather than to the last U.S. person in a chain leading to the foreign beneficial owner of income. As a result, if a partnership does not pay the 1446 tax there is no assurance that the foreign person will file an income tax return and pay the underlying tax liability.

3. *Documentation requirement for foreign simple trusts*

One commentator notes a difference in the documentation requirements for foreign simple trusts under sections 1441 and 1446. The commentator states that under section 1441, a payer of income is required to look through a foreign simple trust and consider the documentation of the beneficiary of such trust, but under section 1446, the foreign simple trust is permitted to provide a Form W–8 (*e.g.*, Form W–8BEN) on its own behalf to the partnership to establish its foreign status. The commentator suggests that the final regulations eliminate this difference and require a partnership to look through a foreign simple trust to the beneficiary of such trust; *i.e.*, require the beneficiary of such trust to provide a Form W–8 or Form W–9 to establish its non-foreign or foreign status for purposes of section 1446, just as the beneficiary is required to do under section 1441.

The final regulations do not adopt this comment. Unlike most situations under section 1441 where the withholding tax arises by reason of a payment of income, the income subject to withholding under section 1446 is generally based upon an amount that may or may not be distributed. As a result, partnership income that is allocable to a foreign simple trust may not enter into a simple trust's computation of income it is required to distribute. The final regulations provide an example of this circumstance where a foreign simple trust does not act as a mere conduit between the partnership and the beneficiary with respect to the trust's allocable share of partnership ECTI. Consequently, Treasury and the IRS believe that it is appropriate for a partnership to compute its 1446 tax liability with respect to a foreign simple trust rather than the trust's beneficiary, and place the obligation on the trust to allocate the tax credit for 1446 tax paid on the trust's share of partnership ECTI between the trust and its beneficiary.

4. *Domestic trust rule*

One commentator requests several modifications to the so-called domestic trust rule. The commentator suggests that the final regulations limit the application of the "reason to know" standard in the rule to situations where the partnership and the partner are related under section 707(b) or where the IRS has formally notified the partnership in writing that the claim of a named partner to be a domestic person exempt from section 1446 withholding is unreliable and must be disregarded. The commentator also suggests that the final regulations specifically provide that the rule does not apply to publicly traded partnerships, nominees, or paying agents that are financial institutions that are otherwise unrelated to the partnership.

Treasury and the IRS believe that the domestic trust rule serves as an important backstop to the foreign trust rules in the regulation and should not be as narrowly limited as the commentator suggests. As a result, the final regulations do not limit the "reason to know" standard to situations where a minimum threshold of ownership can be shown. However, the final regulations provide that a publicly traded partnership within the meaning of §1.1446–4 (or a nominee required to pay 1446 tax under §1.1446–4) will not be considered to know or have reason to know that a domestic trust is formed or availed of to avoid the 1446 tax, provided the interest held in such entity by the domestic trust is publicly traded.

Finally, the commentator suggests that the final regulations clarify the term *other entities* found in the domestic trust rule. In response to this comment, the final regulations have removed the reference to *other entities* to avoid confusion.

E. *Publicly Traded Partnerships—§1.1446–4*

1. *Background*

The proposed regulations contain special rules for publicly traded partnerships to pay withholding tax under section 1446. The rules generally require a publicly traded partnership to pay 1446 tax on distributions of effectively connected income (ECI) to its foreign partners, rather than based upon a foreign partner's allocable share of partnership ECTI. The rules also permit the withholding obligation to be assumed by a domestic nominee holding an interest in the partnership on behalf of one or more foreign partners. The procedural aspects for having the nominee assume this liability were the subject of several comments.

2. *Receipt of a qualified notice and assumption of the 1446 tax liability by a nominee holding an interest in a publicly traded partnership*

Under §1.1446–4(b)(4) of the proposed regulations, a nominee assumes the 1446 tax obligation for a foreign partner on whose behalf it holds an interest in the partnership if the nominee receives a qualified notice from a publicly traded partnership regarding a distribution that is attributable to effectively connected income, gain or loss of the partnership, and that is provided in accordance with the notice requirements with respect to dividends described in 17 C.F.R. 240.10b–17(b)(1) or (3) issued pursuant to the Securities Exchange Act of 1934 (15 U.S.C. 78a). The proposed regulations provide that a nominee shall be treated as a withholding agent only to the extent of the amount specified in the qualified notice. Further, the proposed regulations require a nominee to provide Form W–9, "*Request for Taxpayer Identification Number and Certification*," to the partnership, along with a statement containing certain information

regarding the foreign persons on whose behalf the nominee holds the interest. The proposed regulations provide that if a nominee furnishes Form W–9 and the statement 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 section 1446. Further, in such case the partnership shall presume that such nominee is a nonresident alien or foreign corporation, whichever classification results in a higher 1446 tax being due, and pay 1446 tax consistent with such presumption.

One commentator states that a literal reading of proposed regulation §1.1446–4 requires that a publicly traded partnership provide notice directly to a nominee before the notice is considered a qualified notice under the regulations. The commentator states that if this interpretation of the regulations was intended, then the qualified notice requirement conflicts with standard practice under which a nominee would not receive the qualified notice directly from the partnership when the notice requirements of 17 C.F.R. 240.10b–17(b)(1) or (3) are followed. Instead, under §1.1445–8 and standard practice, notice is deemed to have been received by the nominee when notice is given to the National Association of Securities Dealers (NASD) or the Securities Exchange on which the publicly traded partnership is registered, and such notice is published following certain procedures. Accordingly, the commentator requests clarification as to whether a publicly traded partnership must directly notify a nominee to provide a qualified notice under the regulations, or whether the partnership can follow the general notice procedures of 17 C.F.R. 240.10b–17(b)(1) or (3).

In response, the final regulations clarify when a qualified notice is received by a nominee. The final regulations do not require a publicly traded partnership to directly notify a nominee to provide a qualified notice under §1.1446–4. Rather, the regulations provide, consistent with §1.1445–8 and standard practice, that a publicly traded partnership can provide the qualified notice in accordance with the notice requirements with respect to dividends described in 17 C.F.R. 240.10b–17(1) or (3) issued pursuant to the Securities Exchange Act of 1934, 15 U.S.C. §78a *et. seq.*, and such notice will be sufficient notice to all nominees to designate them as withholding agents under §1.1446–4 when such notice is published in accordance with 17. C.F.R. 240.10b–17(b)(1) or (3).

3. *Identification of nominees under §1.1446–4*

Under §1.1446–4(d) and (e) of the proposed regulations, a nominee is required to provide Form W–9 to the partnership to establish its status as a nominee and include a statement regarding the foreign persons on whose behalf it holds an interest in the partnership. In response to comments, the final regulations remove this requirement. Publicly traded partnerships are provided information concerning nominees in preparation of completing the Schedule K–1s issued for a taxable year. See §1.6031(c)–1T. Further, publicly traded partnerships are able to determine the nominees holding interests in the partnership by other means. Accordingly, Treasury and the IRS have determined that the notification requirement is not necessary to further the purposes of the statute and shift the withholding responsibility to a nominee.

4. *Extension of publicly traded partnership regime to other partnerships*

The proposed regulations requested comments as to whether the special rules applicable to publicly traded partnerships should be extended to other partnerships. No comments were received in response to the request. Accordingly, no change has been made in the final regulations to extend these rules.

5. *Election to pay 1446 tax based upon partners' allocable share of ECTI*

The proposed regulations provide that a publicly traded partnership may elect to pay 1446 tax based upon its foreign partners' allocable share of ECTI, rather than based upon distributions. In response to comments, Treasury and the IRS agree that this election provision is not administrable as a practical matter. Accordingly, the final regulations remove this election so that all publicly traded partnerships will pay tax based upon distributions of effectively connected income under §1.1446–4 of the regulations.

In addition to the change discussed above, the final regulations update the ordering rule with respect to distributions by removing two provisions that are no longer relevant.

F. *Tiered Partnership Structures—§1.1446–5*

1. *Application of the look through rules*

Under the proposed regulations, a lower-tier partnership (LTP) that has received documentation and information from a partner that is a foreign partnership (UTP) may look through the UTP to the partners of the UTP when computing its 1446 tax obligation. The touchstone of proposed regulation §1.1446–5 is that the LTP must be able to reliably associate (within the meaning of §1.1441–1(b)(2)(vii)) the UTP's allocable share of ECTI from the LTP with the partners of the UTP. Several commentators request clarification as to whether an LTP can look through a UTP if the LTP cannot reliably associate 100 percent of the UTP's allocable share with the partners of the UTP.

In response to this comment, the final regulations modify the language found in proposed regulation §1.1446–5(c)(2) to clarify that the look through regime is not an all or nothing proposition. Rather, to the extent that an LTP can reliably associate a portion of a UTP's allocable share of ECTI with a partner of the UTP, the LTP will look through when computing its 1446 tax (or an installment of such tax). This result is consistent with the regime under section 1441. See §1.1441–1(b)(2)(vii)(B)(*2*), *Example 3* and *Example 4*.

2. *Upper-tier domestic partnership permitted to elect to have look through by LTP*

The proposed regulations requested comments on whether the final regulations should permit a domestic UTP to elect to have an LTP look through the UTP in accordance with the rules of §1.1446–5. Several commentators note that this alternative would be desirable and should be permitted in the final regulations. In addition, one commentator requests that, for administrative reasons, an LTP should

be required to consent to the election and agree to undertake the look through.

In response to the above comments, the final regulations permit a domestic UTP to elect to have the look through rules of §1.1446–5 apply. Further, the final regulations require that the LTP consent in writing to the election and thereby agree to apply the rules. The UTP must provide a Form W–9 to the LTP to establish its non-foreign status. In addition, the UTP must attach to the Form W–9 its election to have the look through provisions apply. UTP's election must be in writing to the LTP and received by the LTP at least 15 days prior to any installment due date or Form 8804 filing due date for which it will be considered. The LTP must also consent to undertake the look through in writing. To make an election to which the LTP can consent, the domestic UTP must provide information, consistent with §1.1446–5, to the LTP to enable such partnership to reliably associate (within the meaning of §1.1441–1(b)(2)(vii)) at least a portion of the UTP's allocable share with a foreign partner of the UTP. If the LTP does not consent to the election, then the LTP is to treat the domestic UTP as a U.S. person for purposes of section 1446. Whether the UTP is a domestic or foreign partnership, and regardless of whether the LTP looks through the UTP in computing its withholding tax, the UTP is still obligated to report and pay tax under section 1446.

3. *Clarify the application of the look through rules to publicly traded partnerships in tiered structures*

Section 1.1446–5 of the proposed regulations sets forth the look-through regime applicable to UTPs. The last sentence of proposed regulation §1.1446–5(c)(2) states "[t]he approach set forth in this paragraph (c) shall not apply to partnerships whose interests are publicly traded, See §1.1446–4." However, since the focus of §1.1446–5(c)(2) is on the UTP, one commentator requests clarification as to whether the look-through regime can apply if the LTP is publicly traded but the UTP is not publicly traded.

In response to the request, the final regulations provide two new paragraphs to describe the application of the look through rules to publicly traded partnerships in tiered structures. The rules are based upon whether the publicly traded partnership is an LTP or UTP. Under the final regulations, the look through rules of §1.1446–5 apply to a publicly traded partnership (or its nominees required to pay 1446 tax) that is an LTP if all the requirements of §1.1446–5 are met. However, the final regulations also provide that the look through regime of §1.1446–5 will not apply to look through a publicly traded partnership where such partnership is a UTP.

G. *§1.1446–6T and Withholding in Excess of a Partner's Actual Tax Liability*

1. *Background regarding withholding in excess of a foreign partner's tax liability*

The preamble to the proposed regulations notes that a partnership may be required to pay 1446 tax in excess of a foreign partner's actual tax liability because section 1446 does not take into account a foreign partner's deductions and losses from outside the partnership during the year, or a foreign partner's loss carryovers and, as discussed above, section 1446 requires withholding at the highest statutory rates generally applicable to a foreign partner with effectively connected income. The preamble requested comments on approaches to adjust the amount of a partnership's 1446 tax obligation that would be consistent with the statute and legislative history and administrable by partnerships, partners, and the IRS. One such approach was discussed in part C.1. of this preamble, above.

2. *Overview of comments received*

Treasury and the IRS received numerous comments requesting that a partnership be permitted to take into account a foreign partner's available deductions and losses that are connected with gross income that is effectively connected (effectively connected deductions and losses) when computing the partnership's 1446 tax liability. Most commentators propose that a partnership be permitted to rely on a certificate by a foreign partner regarding the partner's available effectively connected deductions and losses for the taxable year. However, each commentator proposes qualifications and limitations on a foreign partner's ability to certify such deductions and losses. The proposals are discussed below.

Several commentators propose that a foreign partner with a substantial presence in the United States be permitted to certify deductions and losses to the partnership. The commentators differ on what constitutes substantial presence in the United States. For example, one commentator suggests that only foreign partners with a 10 percent or greater interest in the capital or profits of the partnership be permitted to certify deductions and losses. Another commentator suggests that the final regulations permit a foreign partner to certify deductions and losses to the partnership only if the partner has substantial assets in the United States, defined as a multiple of the 1446 tax that the partnership otherwise would be required to pay. A third commentator proposes an exemption from paying 1446 tax where ECTI is allocable to a publicly traded foreign corporation, a foreign corporation owned by a publicly traded corporation, or any other foreign partners with substantial assets, employees, or business activities in the United States to the extent such entity informs the partnership that overwithholding will occur. Finally, one commentator proposes that a U.S. branch of a foreign bank or insurance company be entitled to certify deductions and losses to the partnership, post a security, or otherwise reduce withholding because such banks and insurance companies typically have substantial investments in the United States.

Most of the proposals also suggest some additional measure designed to provide security to the government that the appropriate partner-level U.S. income tax due will be paid. One commentator's proposal conditions a foreign partner's certificate of deductions and losses on the tax book value of the partnership's assets being at least equal to the decrease in 1446 tax that results from considering all foreign partners' certified deductions and losses. This same commentator also suggests that a partnership remain liable for the 1446 tax if it is later determined that a foreign partner's deductions and losses were overstated. A second commentator proposes that at least a portion of a foreign partner's certified deductions and losses should have to be reviewed and approved by a certified tax professional, and considered by a partnership only if at least one

U.S. person is involved in the partnership's activities (*e.g.*, the Tax Matters Partner under section 6231).

With respect to which deductions and losses may be certified, most of the commentators propose that the final regulations permit a foreign partner to certify deductions and losses from preceding years, as reflected on a partner's prior U.S. income tax return. One commentator proposes that a partnership should be able to consider anticipated current year deductions and losses of a foreign partner, such as state and local taxes the partnership will pay on behalf of a foreign partner. Another commentator suggests that the prior year safe harbor in the proposed regulations should be broadened to permit a partnership to consider a foreign partner's actual partner-level deductions and tax liability for the prior year when the partner's only U.S. business activity is the partner's investment in the partnership. Further, one commentator proposes a tiered system where deductions related to the partnership could be certified to the partnership without IRS involvement, but deductions that arise from activities that are unrelated to the partnership would be subject to a more stringent procedure.

With respect to other requirements, most of the commentators premise their proposals on a foreign partner having filed tax returns in previous years. There was no consensus regarding the appropriate filing history that should be required of a foreign partner. However, one commentator proposes a special category, so-called "good driver" partners; that is, foreign partners that have established that they have timely filed Federal income tax returns in the United States for the preceding three taxable years, who would be permitted to certify deductions and losses to the partnership without IRS involvement.

Several commentators propose that partner certificates under section 1446 should be processed similar to the regime in Rev. Proc. 2000–35, 2000–2 C.B. 211, (which permits taxpayers to receive a certificate from the IRS to reduce or eliminate withholding under section 1445). Other commentators suggest that Rev. Proc. 2000–35 should be modified to accommodate a new section 1446 certificate regime.

In response to the comments received, Treasury and the IRS are issuing temporary and proposed regulations on this matter with the final regulations. The temporary and proposed regulations address many of the concerns regarding the potential for section 1446 to require a partnership to pay 1446 tax in excess of a foreign partner's actual tax liability. The effective date of the temporary regulations coincides with the effective date of the final regulations issued in this publication. The temporary regulations contain rules that permit a partnership, in some circumstances, to consider a foreign partner's deductions and losses that are reasonably expected to be available to reduce the partner's U.S. income tax liability on the partner's allocable share of effectively connected income or gain from the partnership in the taxable year. The temporary regulations contain elements of several of the suggested approaches. Treasury and the IRS believe that the regulations set forth a procedure that will be administrable by partnerships, partners, and the IRS. The provisions of the temporary regulations are outlined below.

3. *General overview of temporary regulations*

In general, under the temporary regulations, certain foreign partners may certify deductions and losses to a partnership to reduce the 1446 tax required to be paid by the partnership with respect to ECTI allocable to such partners. A foreign partner's certificate may only be considered for the partnership taxable year for which it is submitted. Therefore, a foreign partner that wants to certify its deductions and losses in consecutive years must submit a new certificate each partnership taxable year in accordance with the time requirements in the regulations (discussed in part G.7. of this preamble) for the certification provisions to apply. Before each installment date or Form 8804 filing date (without regard to extensions), the partnership will determine, on a partner-by-partner basis, whether the procedures of the temporary regulations may apply. A partnership receiving a valid certificate under the temporary regulations is not obligated to consider a partner's certified available deductions and losses (or may consider only a portion of such deductions and losses) in computing its withholding tax liability. Further, in some cases, the temporary regulations may prohibit a partnership from considering all of a partner's certified losses. For example, the temporary regulations provide that a partnership may only consider a foreign partner's certified net operating loss (NOL) to offset 90 percent of the partner's allocable share of ECTI.

Under the temporary regulations, a partnership permitted to consider a foreign partner's certificate is generally not relieved from liability for the 1446 tax under section 1461, or for penalties or interest, if the partnership or the IRS, in its sole discretion, determines that the partner's certificate is defective, or the partner's certificate is updated and the 1446 tax due with respect to such partner increases. However, a partnership that reasonably relies on a foreign partner's certificate will not be subject to the addition to the tax under section 6655 (as applied through §1.1446–3) for failing to make installment payments with respect to the foreign partner during any period that the partnership reasonably relied on the partner's certificate. A partnership that does not have actual knowledge or reason to know that a foreign partner's certificate is defective may reasonably rely on such certificate. A partnership is not considered to have actual knowledge or reason to know that a foreign partner's certificate (first certificate) is defective if the partner submits an updated certificate that indicates that the reasonably expected deductions and losses are less than the amount set forth on the first certificate, provided such updated certificate cannot be considered for the installment period or unextended Form 8804 filing date because such updated certificate was received less than 10 days before such date. The temporary regulations set forth those circumstances under which a certificate will be considered defective, including, but not limited to, where the foreign partner is not eligible to submit the certificate, or the partnership or the IRS determines that the partner's actual available deductions and losses are less than the deductions and losses last certified to the partnership for the partnership taxable year.

The regulations also contain rules and examples regarding the extent of the partnership's 1446 tax liability when a certificate is determined to be defective. The regulations provide that if a certificate is determined to be defective for a reason other than the amount or character of the

deductions and losses set forth on such certificate (*e.g.*, partner failed to timely file a U.S. income tax return), then the partnership shall be liable for the full 1446 tax (or any installment of such tax) due with respect to such partner, without regard to the certificate. However, this liability may be eliminated if the partnership can demonstrate that it is deemed to have paid 1446 tax with respect to the partner under the regulations. See part C.6. of this preamble. If it is determined that a certificate is defective because the actual deductions and losses available to the foreign partner are less than the amount certified to the partnership (other than when it is determined that the partner certified the same deduction or loss to more than one partnership), or that the character of the certified deductions and losses is erroneous, then the partnership shall be liable for 1446 tax (or any installment of such tax) with respect to such partner only to the extent the partnership considered the certified deductions and losses in an amount greater than the amount determined to be actually available to the partner and permitted to be used under §1.1446–1 through §1.1446–6T or to the extent the erroneous characterization of the certified deductions and losses affects the calculation of the partnership's 1446 tax liability.

If the IRS notifies the partnership that a foreign partner's certificate is defective, even if such notice pertains to a certificate submitted for a prior partnership taxable year, the partnership will not be permitted to rely on any current certificate from the foreign partner then in its possession, or any certificate the foreign partner submits thereafter, until the IRS again notifies the partnership in writing and revokes or modifies the original notice.

The procedures available under the temporary regulations are only available to a foreign partner that has provided adequate documentation to a partnership under §1.1446–1. Further, the procedures do not apply to a publicly traded partnership subject to §1.1446–4.

4. *Partners permitted to certify deductions and losses under temporary regulations*

Under the temporary regulations, only certain foreign partners may submit a certificate to a partnership for purposes of section 1446. In general, a foreign partner may submit a certificate only if the partner has submitted documentation to the partnership in compliance with §1.1446–1 and, among other requirements, can represent that it timely filed, or will timely file, a U.S. Federal income tax return for each of the preceding four taxable years and the partner's taxable year during which the certificate is considered. The partner must also represent that it timely paid all tax shown on such returns (or will timely pay all tax shown on such returns). The filing and payment requirements ensure that the foreign partner is in the United States income tax system, has filed returns for a reasonable period of time, and provide some assurance that the partner will file its U.S. income tax return (and pay all tax shown on such return) for the year the certificate is considered. Although the temporary regulations are generally effective for partnership taxable years beginning after the date that the regulations are issued, a foreign partner's prior filing of U.S. Federal income tax returns may contribute to meet the filing requirement set forth in the temporary regulations.

Because trusts and estates are not always pure conduits for tax purposes, it is difficult for a partnership to determine the taxpayer (*i.e.*, trust/estate or beneficiary) that will pay tax on the ECTI allocated to the trust or estate. As a result, the temporary regulations generally do not permit foreign trusts or estates to submit a certificate to the partnership. However, the regulations provide an exception for a grantor trust under sections 671 through 679 of the Code where the grantor or other owner of such trust meets the documentation requirements set forth in §1.1446–1 and the requirements for submitting a certificate under the temporary regulations.

With respect to tiered partnership structures, the temporary regulations permit a lower-tier partnership to consider the certificate of a foreign partner of an upper-tier partnership only when the look through provisions of the regulations (section 1.1446–5) otherwise apply and the lower-tier partnership is treating the foreign partner of the upper-tier partnership as if the partner were a direct partner in the lower-tier partnership for purposes of computing its section 1446 tax obligation. See §1.1446–5(c)(2). In that situation, the foreign partner's certificate would first be provided to the upper-tier partnership and then provided by the upper-tier partnership to the lower-tier partnership.

5. *Deductions and losses permitted to be certified under temporary regulations*

If a foreign partner meets the requirements of the temporary regulations, the foreign partner may submit a certificate to the partnership for the partnership taxable year that sets forth the deductions and losses (other than charitable deductions) the partner reasonably expects to be available to reduce the partner's U.S. income tax liability on the partner's allocable share of effectively connected income or gain from the partnership for such partnership taxable year. Except as otherwise provided in the regulations, all deductions and losses set forth in the certificate must generally be reflected on the partner's timely filed (or to be timely filed) U.S. income tax return for the partner's immediately preceding taxable year. That is, a foreign partner can only certify deductions and losses that are or will be reflected on the partner's U.S. income tax return filed for a taxable year ending prior to the installment due date or Form 8804 filing date (without regard to extensions) for the partnership taxable year for which the certificate is considered (and no anticipated deduction or loss with respect to current operations may be considered). However, a partner that has a loss that is set forth on a Schedule K–1 issued by the partnership for a prior year, but is not reflected on a prior year return because the loss was suspended under section 704(d) and, therefore, not deductible, may certify such loss to the partnership that issued the Schedule K–1.

Treasury and the IRS believe that limiting a partnership's consideration of deductions and losses to those reflected or to be reflected on a prior year return of the partner provides a bright line rule that facilitates administration, furthers the purposes of the statute, and avoids the uncertainty associated with fluctuations in estimates of current year activities. The approach is consistent with section 1445, another chapter 3 withholding regime. See Rev. Proc. 2000–35, 2000–2 C.B. 211, §4.06. The temporary regulations contain additional limitations on the deductions and losses that may be certified.

6. *Requirement under temporary regulations that partnerships turn over certificates to IRS*

A partnership that considers a foreign partner's certificate to any extent when computing its 1446 tax (or any installment of such tax) must file Form 8813, "*Partnership Withholding Tax Payment Voucher (Section 1446)*," or Forms 8804 and 8805, whichever is applicable, for the period the partnership considers such certificate, even if there is no 1446 tax due with respect to such partner. The partnership must attach such partner's certificate to Form 8813 or Form 8805 filed for the period. The partnership must also attach its 1446 tax calculation for such foreign partner and such calculation must clearly demonstrate the use of the certified deductions and losses, and the effect on the 1446 tax owed (or installment of such tax) with respect to such partner. A Form 8805 must be issued to each foreign partner whose certificate is considered by the partnership in computing the partnership's 1446 tax on Form 8804, regardless of whether the partnership must pay any 1446 tax.

7. *Timing requirements for submitting certificates, updated certificates, and status updates under temporary regulations*

A foreign partner that desires to certify deductions and losses to a partnership under the temporary regulations must submit its first certificate for the partnership taxable year so that it is received by the partnership at least 30 days prior to the partnership installment due date or the Form 8804 filing date (without regard to extensions) for the partnership taxable year for which the partner would like the certificate to be considered in the partnership's computation of the 1446 tax (or any installment of such tax) due with respect to the partner. A partner that has not yet filed a U.S. income tax return required to be timely filed under the regulations may generally represent that such return will be timely filed. However, the certificate submitted to the partnership must specify any taxable year for which no return has been filed and the partner must update the certificate no later than 10 days after the date that it files a U.S. Federal income tax return for any year specified. If the partner has not filed a prior year return when submitting its first certificate, and does not file such return and trigger the requirement to provide an updated certificate, then the foreign partner must provide a status update to the partnership so that it is received by such partnership at least ten days prior to the partnership's final installment payment date, setting forth such information regarding the filing due date of any U.S. income tax returns that have not been filed. If no status update is received, the partnership must disregard the certificate the partner submitted for the fourth installment due date and when completing its Form 8804 for the taxable year. In that case, provided the other requirements of the regulations were met, the partnership will still be considered to have reasonably relied on the certificate for the first three installment periods of the taxable year.

A foreign partner that submits a certificate and later determines that the deductions and losses reasonably expected to be available are less than the corresponding amounts previously certified for the taxable year, or otherwise determines that the certificate is incorrect (*e.g.*, a certified ordinary loss is actually capital in character), is required to provide an updated certificate to the partnership within 10 days of the date that the foreign partner makes such determination. A partner submitting an updated certificate must attach a copy of the certificate that is being updated (superseded certificate).

Consistent with the voluntary nature of the temporary regulations, a partnership may consider an updated certificate in its computation of 1446 tax (or any installment of such tax) due with respect to a foreign partner for any period for which tax is otherwise due if the partnership receives the updated certificate at least 10 days prior to the installment payment or Form 8804 filing date (without regard to extensions) for the partnership taxable year for which the certificate and updated certificate are submitted. An updated certificate that may be considered under the previous sentence supersedes all prior certificates submitted by the foreign partner for the same partnership taxable year, beginning with the installment period or Form 8804 filing date (without regard to extensions) for which the partnership may consider the updated certificate.

8. *Additional requirements for certificates under temporary regulations*

The temporary regulations require a foreign partner that submits a certificate to a partnership to provide certain information and make representations on the certificate provided. For example, a foreign partner must provide the partnership a certificate that includes the partnership's name, address, and Taxpayer Identification Number (TIN), the partner's name, address, and TIN, and the partnership taxable year for which the certificate is submitted. Further, a foreign partner must represent that any certified deductions and losses set forth on the certificate have been reflected on a timely filed U.S. income tax return, consistent with sections 874 and 882 and the regulations thereunder, and that the certified deductions and losses have not been certified to another partnership for the purpose of reducing the 1446 tax of such other partnership for the same taxable year. Moreover, a foreign partner must set forth the character of any certified deductions and losses (*e.g.*, long-term capital or ordinary) and identify any particular deductions and losses that have special characteristics (*e.g.*, passive activity losses under section 469, suspended losses under section 704(d)) or that are subject to limitations that need to be considered by the partnership. Finally, a foreign partner must represent that the certified deductions and losses have not been disallowed by the IRS as part of a proposed adjustment described in §601.103(b) (relating to examination and determination of tax liability) or §601.105(b) (relating to examination of returns). A foreign partner's certificate, and any updated certificate, must be signed by the foreign partner, or its authorized representative, under penalties of perjury.

9. *Exemption from withholding under the temporary regulations*

In addition to the provisions discussed above, the temporary regulations permit a nonresident alien partner to certify to the partnership that the partnership investment is (and will be) the only activity of the partner for the partner's taxable year that gives rise to effectively connected income, gain, deduction, or loss. In such a case, the partnership is not required to pay 1446

tax (or any installment of such tax) with respect to such partner if the partnership estimates that the annualized (or, in the case of a partnership completing its Form 8804, the actual) 1446 tax due with respect to such nonresident alien partner is less than $1,000. In determining whether the annualized (or actual) 1446 tax due with respect to the partner is less than $1,000, the partnership shall not take into account any of the partner's certified deductions or losses under the provisions of the temporary regulations. The submission of a certificate under this exception is subject to all the general rules in the temporary regulations (*e.g.*, partner has (or will) timely file its U.S. income tax return for the preceding four years (and pay all tax shown on such returns), the timing rules for submission of the certificate are met) with respect to submitting a certificate. Further, a nonresident alien partner that submits such a certificate to the partnership must submit a statement in writing to the partnership revoking the certificate if the partner invests or otherwise engages in another activity during the partner's taxable year that may give rise to effectively connected items. A partnership receiving a statement that the partner's investment in the partnership is (and will be) the partner's only activity giving rise to effectively connected items may reasonably rely on such certificate provided it has no actual knowledge or reason to know that the certificate is defective. Further, the partnership remains liable for the 1446 tax, and all additions to the tax (other than the addition to the tax under section 6655 as applied through §1.1446–3 for such periods during which the partnership reasonably relied on the certificate), interest, and penalties if the IRS, in its sole discretion, determines that such partner's certificate is defective.

10. *Effective Date of Temporary Regulations*

The temporary regulations are effective for partnership taxable years beginning after the date the final regulations are published in the **Federal Register**. However, Treasury and the IRS believe that the temporary regulations should be immediately available for qualifying partners. Therefore, a partnership may elect to apply the temporary regulations to partnership taxable years beginning after December 31, 2004, provided such partnership also elects to apply the final regulations under §§1.1446–1 through 1.1446–5, which otherwise would be effective for taxable years beginning after May 18, 2005, to partnership taxable years beginning after December 31, 2004.

Effective Dates

These regulations are effective for partnership taxable years beginning after May 18, 2005. However, a partnership may elect to apply the provisions of the final regulations to partnership taxable years beginning after December 31, 2004. A partnership may also elect to apply the temporary regulations included in this document to partnership taxable years beginning after December 31, 2004, provided that the partnership also elects to apply the final regulations to partnership taxable years beginning after December 31, 2004.

Effect on Other Documents

The following publications will be obsolete for partnership taxable years beginning after May 18, 2005, or for partnership taxable years beginning after December 31, 2004, if the partnership makes an election under §1.1446–7:

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 the final and temporary regulations are not a significant regulatory action as defined in Executive Order 12866. It also has been determined that section 553(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations. With respect to the final regulations, it is hereby certified that 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), 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 0.5 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 0.5 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. For applicability of the RFA to the temporary regulation, please refer to the cross-referenced NPRM published elsewhere in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, the Notice of Proposed Rulemaking preceding the final regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. Further, pursuant to section 7805(f) of the Code, the temporary regulation included in this document has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

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

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR parts 1, 301, and 602 are 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 four sentences at the end of the 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*. * * * A nonresident alien or foreign corporation that makes an election generally must provide the partnership a Form W–8ECI, "*Certificate of Foreign Person's Claim for Exemption From Withholding on Income Effectively Connected With the Conduct of a Trade or Business in the United States*," and attach to such form a copy of the election (or a statement that indicates that the nonresident alien or foreign corporation will make the election). However, if the nonresident alien or foreign corporation has already submitted a valid form to the partnership that establishes such partner's foreign status, the partner shall furnish the partnership a copy of the election (or a statement that indicates that the nonresident alien or foreign corporation will make the election). To the extent the partnership has income to which the election pertains, the partnership shall treat such income as effectively connected income subject to withholding under section 1446. See also §1.1446–2.

(e) *Effective dates*. This section shall apply for taxable years beginning after December 31, 1966, except the last four sentences of paragraph (d)(3) of this section shall apply to partnership taxable years beginning after May 18, 2005, or such earlier time as the regulations under §§1.1446–1 through 1.1446–5 apply by reason of an election under §1.1446–7.* * *

Par. 3. Section 1.1443–1 is amended by revising paragraphs (a) and (c)(1) to 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 and section 513 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 1.1446–6T, in the same manner as payments or allocations of effectively connected taxable income of the same amounts made to any foreign person that is not a tax-exempt organization. Therefore, a foreign organization receiving amounts includible under section 512 and section 513 in computing the organization's unrelated business taxable income may claim an exemption from withholding or a reduced rate of withholding with respect to that income in the same manner as a foreign person that is not a tax-exempt organization. See §1.1441–9(b)(3) for a presumption that amounts are includible under section 512 and section 513 in computing the organization's unrelated business taxable income in the absence of reliable certification. See also §1.1446–3(c)(3), applying this presumption in the context of section 1446.

* * * * *

(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 May 18, 2005, or such earlier time as the regulations under §§1.1446–1 through 1.1446–5 apply by reason of an election under §1.1446–7.

* * * * *

Par. 4. Sections 1.1446–0 through 1.1446–5, 1.1446–6T and 1.1446–7 are added to read as follows:

§1.1446–0 Table of contents. This section lists the captions contained in §§1.1446–1 through 1.1446–7.

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

(a) In general.

(b) Steps in determining 1446 tax obligation.

(c) Determining whether a partnership has a foreign partner.

(1) In general.

(2) Submission of Forms W–8BEN, W–8IMY, W–8ECI, W–8EXP, and W–9.

(i) In general.

(ii) Withholding certificate applicable to each type of partner.

(A) U.S. person.

(B) Nonresident alien.

(C) Foreign partnership.

(D) Disregarded entities.

(E) Domestic and foreign grantor trusts.

(F) Nominees.

(G) Foreign governments, foreign tax-exempt organizations and other foreign persons.

(H) Foreign corporations, certain foreign trusts, and foreign estates

(iii) Effect of Forms W–8BEN, W–8IMY, W–8ECI, W–8EXP, W–9, and statement.

(A) Partnership reliance on withholding certificate.

(B) Reason to know.

(C) Subsequent knowledge and impact on penalties.

(iv) Requirements for certificates to be valid.

(A) When period of validity expires.

(B) Required information for Forms W–8BEN, W–8IMY, W–8ECI, and W–8EXP.

(v) Partner must provide new withholding certificate when there is a change in circumstances.

(vi) Partnership must retain withholding certificates.

(3) Presumptions in the absence of valid Form W–8BEN, Form W–8IMY, Form W–8ECI, Form W–8EXP, Form W–9, or statement.

(4) Consequences when partnership knows or has reason to know that Form W–8BEN, Form W–8IMY, Form W–8ECI, Form W–8EXP, or Form W–9 is incorrect or unreliable and does not withhold.

(5) Acceptable substitute form.

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

(a) In general.

(b) Computation.

(1) In general.

(2) Income and gain rules.

(i) Application of the principles of section 864.

(ii) Income treated as effectively connected.

(iii) Exempt income.
(3) Deductions and losses.
(i) Oil and gas interests.
(ii) Charitable contributions.
(iii) Net operating losses and other suspended or carried losses.
(iv) Interest deductions.
(v) Limitation on capital losses.
(vi) Other deductions.
(vii) Limitations on deductions.
(4) Other rules.
(i) Exclusion of items allocated to U.S. partners.
(ii) Partnership credits.
(5) Examples.

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

(a) In general.
(1) Calculating 1446 tax.
(2) Applicable percentage.
(i) In general.
(ii) Special types of income or gain.
(b) Installment payments.
(1) In general.
(2) Calculation.
(i) General application of the principles of section 6655.
(ii) Annualization methods.
(iii) Partner's estimated tax payments.
(iv) Partner whose interest terminates during the partnership's taxable year.
(v) Exceptions and modifications to the application of the principles under section 6655.
(A) Inapplicability of special rules for large corporations.
(B) Inapplicability of special rules regarding early refunds.
(C) Period of underpayment.
(D) Other taxes.
(E) 1446 tax treated as tax under section 11.
(F) Application of section 6655(f).
(G) Application of section 6655(i).
(H) Current year tax safe harbor.
(I) Prior year tax safe harbor.
(3) 1446 tax safe harbor.
(i) In general.
(ii) Permission to change to standard annualization method.
(c) Coordination with other withholding rules.
(1) Fixed or determinable, annual or periodical income.
(2) Real property gains.
(i) Domestic partnerships.
(ii) Foreign partnerships.
(3) Coordination with section 1443.
(d) Reporting and crediting the 1446 tax.
(1) Reporting 1446 tax.
(i) Reporting of installment tax payments and notification to partners of installment tax payments.
(ii) Payment due dates.
(iii) Annual return and notification to partners.
(iv) Information provided to beneficiaries of foreign trusts and estates.
(v) Attachments required of foreign trusts and estates.
(vi) Attachments required of beneficiaries of foreign trusts and estates.
(vii) Information provided to beneficiaries of foreign trusts and estates that are partners in certain publicly traded partnerships.
(2) Crediting 1446 tax against a partner's U.S. tax liability.
(i) In general.
(ii) Substantiation for purposes of claiming the credit under section 33.
(iii) Special rules for apportioning the tax credit under section 33.
(A) Foreign trusts and estates.
(B) Use of domestic trusts to circumvent section 1446.
(iv) Refunds to withholding agent.
(v) 1446 tax treated as cash distribution to partners.
(vi) Examples.
(e) Liability of partnership for failure to withhold.
(1) In general.
(2) Proof that tax liability has been satisfied and deemed payment of 1446 tax.
(3) Liability for interest, penalties, and additions to the tax.
(i) Partnership.
(ii) Foreign partner.
(4) Examples.
(f) Effect of withholding on partner.

§1.1446–4 Publicly traded partnerships.

(a) In general.
(b) Definitions.
(1) Publicly traded partnership.
(2) Applicable percentage.
(3) Nominee.
(4) Qualified notice.
(c) Paying and reporting 1446 tax.
(d) Rules for designation of nominees to withhold tax under section 1446.
(e) Determining foreign status of partners.
(f) Distributions subject to withholding.
(1) In general.
(2) In-kind distributions.
(3) Ordering rule relating to distributions.
(4) Coordination with section 1445(e)(1).

§1.1446–5 Tiered partnership structures.

(a) In general.
(b) Reporting requirements.
(1) In general.
(2) Publicly traded partnerships.
(c) Look through rules for foreign upper-tier partnerships.
(d) Publicly traded partnerships.
(1) Upper-tier publicly traded partnership.
(2) Lower-tier publicly traded partnership.
(e) Election by a domestic upper-tier partnership to apply look through rules.
(1) In general.
(2) Information required for valid election statement.
(3) Consent of lower-tier partnership.
(f) Examples.

§1.1446–6T Special rules to reduce a partnership's 1446 tax with respect to a foreign partner's allocable share of effectively connected taxable income (temporary).

(a) In general.
(b) Foreign partner to whom this section applies.
(1) In general.
(2) Special rules.
(c) Certificate to reduce 1446 tax with respect to a foreign partner.
(1) In general.
(i) Deductions and losses from the partnership from prior taxable years.
(ii) Deductions and losses from sources other than the partnership from prior taxable years.
(iii) Limit on the consideration of a partner's net operating loss deduction.
(iv) Certificate of nonresident alien partner that partnership investment is partner's only activity giving rise to effectively connected items.
(2) Time and form of certification.
(i) Time for certification provided to partnership.

(A) First certificate submitted for a partnership's taxable year.

(B) Updated certificates and status updates.

(*1*) Foreign partner's prior year tax returns not yet filed.

(*2*) Other circumstances requiring a foreign partner to submit an updated certificate.

(*3*) Form and content of updated certificate.

(*4*) When partnership may consider an updated certificate.

(ii) Form of certification.

(3) Notification to partnership when a partner's certificate cannot be relied upon.

(4) Partner to receive copy of notice.

(5) Partner's certificate valid only for partnership taxable year for which submitted.

(d) Effect of certificate of deductions and losses on partners and partnership.

(1) Effect on partner.

(i) No effect on substantive tax liability of foreign partner.

(ii) No effect on partner's estimated tax obligations.

(2) Effect on partnership.

(i) Reasonable reliance to relieve partnership from addition to the tax under section 6655.

(ii) Filing requirement.

(iii) Continuing liability for withholding tax under section 1461 and for applicable interest and penalties.

(iv) Partner's certified deductions and losses to offset foreign partner's annualized allocable share of partnership ECTI.

(e) Examples.

(f) Effective dates.

§1.1446–7 Effective dates.

§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 (ECTI) as computed under §1.1446–2 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 prescribed in this section, and §§1.1446–2 through 1.1446–6T.

(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 under section 704 to one or more of the foreign partners. If the partnership has ECTI allocable under section 704 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. For special rules that may apply in determining the amount of 1446 tax due with respect to a partner, see §1.1446–6T.

(c) *Determining whether a partnership has a foreign partner*—(1) *In general*. Except as otherwise provided in this section, §1.1446–3, and §1.1446–5, only a partnership that has at least one foreign partner during the partnership's taxable year can have a 1446 tax liability. Generally, the term foreign partner means any partner of the partnership that is not a U.S. person within the meaning of section 7701(a)(30). Thus, a partner of the partnership is generally a foreign partner if the partner is a nonresident alien, foreign partnership (see §1.1446–5 for rules that allow a lower-tier partnership to look through an upper-tier foreign partnership to the partners of such partnership for purposes of computing its 1446 tax), foreign corporation (which includes a foreign government pursuant to section 892(a)(3)), foreign estate or trust (see paragraph (c)(2) of this section for rules that instruct a partnership to consider the grantor or other owner of a trust under subpart E of subchapter J as the partner for purposes of computing the partnership's 1446 tax), as those terms are defined under section 7701 and the regulations thereunder, or a foreign organization described in section 501(c), or other foreign person. A person also is a foreign partner if the person is presumed to be a foreign person under paragraph (c)(3) of this section. 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) and 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 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 1446 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) *Submission of Forms W–8BEN, W–8IMY, W–8ECI, W–8EXP, 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 generally determine whether a partner is a foreign partner, and the partner's tax classification (*e.g.*, corporate or non-corporate), by obtaining a withholding certificate from the partner that is 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*," Form W–8ECI, "*Certificate of Foreign Person's Claim for Exemption From Withholding on Income Effectively Connected With the Conduct of a Trade or Business in the United States*," Form W–8EXP, "*Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding*," or a Form W–9, as applicable, or an acceptable substitute form permitted under paragraph (c)(5) of this section. Generally, a foreign partner that is a nonresident alien, 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.

(ii) *Withholding certificate applicable to each type of partner*. A partner that

submits a valid Form W–8 (*e.g.*, Form W–8BEN) for purposes of section 1441 or 1442 will generally satisfy the documentation requirements of this section provided that the submission of such form is not inconsistent with the rules of this paragraph (c)(2) or paragraph (c)(3) of this section. The following rules shall apply for purposes of this section.

(A) *U.S. person.* A partner that is a U.S. person (other than a grantor trust described in this paragraph (c)(2)), including a domestic partnership and domestic simple or complex trust (including an estate), shall provide a valid Form W–9.

(B) *Nonresident alien.* A Form W–8 (*e.g.*, Form W–8BEN) submitted by a nonresident alien for purposes of withholding under section 1441 will generally be accepted for purposes of section 1446. If no such form is submitted for purposes of section 1441, such nonresident alien shall submit Form W–8BEN for purposes of section 1446.

(C) *Foreign partnership.* A partner that is a foreign partnership generally shall provide a valid Form W–8IMY for purposes of section 1446. See §1.1446–5 (permitting a lower-tier partnership to look through an upper-tier foreign partnership in certain circumstances when computing 1446 tax).

(D) *Disregarded entities.* An entity that is disregarded as an entity separate from its owner under §301.7701–3 of this chapter (whether domestic or foreign) shall not submit a Form W–8 (*e.g.*, Form W–8BEN) or Form W–9. Instead, the owner of such entity for Federal tax purposes shall submit appropriate documentation to comply with this section. See §§301.7701–1 through 301.7701–3 of this chapter for determining the U.S. Federal tax classification of a partner.

(E) *Domestic and foreign grantor trusts.* To the extent that a grantor or other 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 provide documentation under this paragraph (c)(2) to identify the trust as a grantor trust and provide documentation on behalf of the grantor or other person treated as the owner of all or a portion of such trust as required by this paragraph (c)(2). If such trust is a foreign trust, the trust shall submit Form W–8IMY to the partnership identifying itself as a foreign grantor trust and shall provide such documentation (*e.g.*, Forms W–8BEN, W–8IMY, W–8ECI, W–8EXP, or W–9) and information pertaining to its grantor or other owner 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 domestic grantor trust and such statement shall identify 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, W–8ECI, W–8EXP, or W–9) pertaining to its grantor or other 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.

(F) *Nominees.* Where a nominee holds an interest in a partnership on behalf of another person, the beneficial owner of the partnership interest, not the nominee, shall submit a Form W–8 (*e.g.*, Form W–8BEN) or Form W–9 to the partnership or nominee that is the withholding agent.

(G) *Foreign governments, foreign tax-exempt organizations and other foreign persons.* A Form W–8 (*e.g.*, Form W–8EXP) submitted by a partner that is a foreign government, foreign tax-exempt organization, or other foreign person for purposes of withholding under §§1441 through 1443 will also operate to establish the foreign status of such partner under this section. However, except as set forth in §1.1446–3(c)(3) (regarding certain tax-exempt organizations described in section 501(c)), the submission of Form W–8EXP will have no effect on whether there is a 1446 tax due with respect to such partner's allocable share of partnership ECTI. For example, a partnership must still pay 1446 tax with respect to a foreign government partner's allocable share of ECTI because such partner is treated as a foreign corporation under section 892(a)(3). If no Form W–8 is submitted for purposes of withholding under sections 1441 through 1443, then such government, tax-exempt organization, or person must generally submit Form W–8BEN.

(H) *Foreign corporations, certain foreign trusts, and foreign estates.* Consistent with the rules of this paragraph (c)(2) and paragraph (c)(3) of this section, a foreign corporation, a foreign trust (other than a foreign grantor trust described in paragraph (c)(2)(ii)(E) of this section), or a foreign estate may generally submit any appropriate Form W–8 (*e.g.*, Form W–8BEN) to the partnership to establish its foreign status for purposes of section 1446.

(iii) *Effect of Forms W–8BEN, W–8IMY, W–8ECI, W–8EXP, W–9, and statement*—(A) *Partnership reliance on withholding certificate.* In general, for purposes of this section, a partnership may rely on a valid Form W–8 (*e.g.*, Form W–8BEN) or Form W–9, or statement described in this paragraph (c)(2) from a partner, beneficial owner, or grantor trust to determine whether that person, beneficial owner, or the owner of a grantor trust, is a non-foreign or foreign partner for purposes of computing 1446 tax, and if such person is a foreign partner, to determine whether or not such person is a corporation for U.S. tax purposes. The rules of paragraph (c)(3) of this section shall apply to a partnership that 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–8 (*e.g.*, Form W–8BEN) or Form W–9 identifying such grantor or other person. Further, a partnership may not rely on a Form W–8 or Form W–9, or statement described in this paragraph (c)(2), and such form or statement is therefore not valid for any installment period or Form 8804 filing date during which 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, the partnership should pay 1446 tax in an amount greater than would be the case if it relied on the certificate or statement.

(B) *Reason to know.* 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).

(C) *Subsequent knowledge and impact on penalties*. If the partnership does not have actual knowledge or reason to know that a Form W–8BEN, Form W–8IMY, Form W–8ECI, Form W–8EXP, Form W–9, or statement received from a partner, beneficial owner, or grantor trust contains incorrect or unreliable information, but it subsequently determines that the certificate or statement contains 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 certificate or statement, then the partnership will not be subject to penalties for its failure to pay the 1446 tax in reliance on such certificate 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 a withholding certificate or statement is incorrect or unreliable.

(iv) *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, Form W–8IMY, Form W–8ECI, or Form W–8EXP 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, Form W–8IMY, Form W–8ECI, or Form W–8EXP 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, W–8IMY, W–8ECI, and W–8EXP*. Forms W–8BEN, W–8IMY, W–8ECI, and W–8EXP 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 for such form, as applicable.

(v) *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.

(vi) *Partnership must retain withholding certificates*. A partnership or nominee who has responsibility for paying 1446 tax under this section or §1.1446–4 must retain each withholding certificate, statement, and other information received from its direct and indirect partners for as long as it may be relevant to the determination of the withholding agent's 1446 tax liability under section 1461 and the regulations thereunder.

(3) *Presumptions in the absence of valid Form W–8BEN, Form W–8IMY, Form W–8ECI, Form W–8EXP, 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–8ECI, Form W–8EXP, Form W–9, or statement required by paragraph (c)(2) of this section from a partner, 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. Except as provided in §1.1446–3(a)(2) and §1.1446–5(c)(2), a partnership that knows that a partner is an individual shall treat the partner as a nonresident alien. Except as provided in §1.1446–3(a)(2) and §1.1446–5(c)(2), a partnership that knows that a partner is an entity shall treat the partner as a corporation if the entity is a corporation as defined in §301.7701–2(b)(8) of this chapter. See §1.1446–3(a)(2) which prohibits a partnership in certain circumstances from considering preferential tax rates in computing its 1446 tax when the presumption and rules of this paragraph (c)(3) apply. In all other cases, the partnership shall treat the partner as either a nonresident alien 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. Except as provided in §1.1446–5(c)(2), the presumption set forth in this paragraph (c)(3) that a partner is a foreign person 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 an acceptable certificate under this section. If a certificate 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, Form W–8ECI, Form W–8EXP, or Form W–9 is incorrect or unreliable and does not withhold*. If a partnership has actual knowledge or has reason to know that a Form W–8BEN, Form W–8IMY, Form W–8ECI, Form W–8EXP, Form W–9, or statement required by paragraph (c)(2) of this section submitted by a partner, 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 1446 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) and §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 has such knowledge or reason to know that the certificate contained incorrect or unreliable information and for all subsequent installment periods. If a partner, beneficial owner, or grantor trust submits a new valid Form W–8BEN, Form W–8IMY, Form W–8ECI, Form W–8EXP, Form W–9, or statement, as applicable, the partnership may rely on that documentation when paying 1446 tax (or any installment of such tax) for any payment date that has not passed at the time such form is received.

(5) *Acceptable substitute form.* A partnership or withholding agent responsible for paying 1446 tax (or any installment of such tax) may substitute its own form for the official version of Form W–8 (*e.g.*, Form W–8BEN) that is recognized under this section to ascertain the identity of its partners, provided such form is consistent with §1.1441–1(e)(4)(vi). All references under this section or §§1.1446–2 through 1.1446–6T to a Form W–8 (*e.g.*, Form W–8BEN, Form W–8IMY, Form W–8ECI, Form W–8EXP) shall include the acceptable substitute form recognized under this paragraph (c)(5).

§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) or any installment of such 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. See §1.1446–6T (special rules permitting the partnership to consider partner-level deductions and losses to reduce the partnership's 1446 tax). The calculation of partnership ECTI allocable to foreign partners as set forth in paragraph (b) of this section and the partnership's withholding tax obligation are partnership-level computations 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(a) 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. See §1.1446–6T (special rules permitting the partnership to consider partner-level deductions and losses to reduce the partnership's 1446 tax). 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 and, when applicable, sections 1.1446–3(a)(2) (consideration of preferential rates when computing 1446 tax) and section 1.1446–6T (special rules permitting the partnership to consider partner-level deductions and losses to reduce the partnership's 1446 tax).

(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 shall apply with respect to partnership income and gain.

(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 include 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 Internal Revenue Code, without regard to whether those amounts are taxable to the partner. A partner that makes the election under section 871(d) or section 882(d) shall furnish to the partnership a statement that indicates that such election has been made. See §1.871–10(d)(3). If a partnership receives a valid Form W–8ECI from a partner, the partner is deemed, for purposes of section 1446, to have effectively connected income subject to withholding under section 1446 to the extent of the items identified on the form.

(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 (see §1.1446–1(c)(2)(iii) regarding when a Form W–8BEN is valid for purposes of this section), containing the information necessary to support the claim for treaty benefits required in the forms and instructions. In addition, for purposes of this section, the withholding certificate must contain the beneficial owner's taxpayer identification number.

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

(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*. Except as provided in §1.1446–6T, the net operating loss deduction of any foreign partner provided in section 172 shall not be taken into account. Further, except as provided in §1.1446–6T, 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 a 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 §1.1446–6T and this paragraph (b)(3), 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*. Except as provided in §1.1446–5(e), in computing partnership ECTI, 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).

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

(5) *Examples*. The following examples illustrate the application of this section. In considering the examples, disregard the potential application of §1.1446–3(b)(2)(v)(F) (relating to the *de minimis* exception to paying 1446 tax). The examples are as follows:

Example 1. Limitation on capital losses. PRS partnership has two equal partners, A and B. A is a nonresident alien 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. Accordingly, A's share of partnership ECTI allocable under section 704 pursuant to §1.1446–2 is $100 ($150 of ordinary income less $50 of ordinary deductions, plus $50 of capital gain 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 aliens. 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. Assume that these 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 under §1.1446–2 is $400 (consisting of $200 of ordinary income and $200 of long-term capital gain), and B's allocable share of partnership ECTI is $200 (consisting of $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. FC's net operating loss carryover is not taken into account in determining FC's allocable share of partnership ECTI under §1.1446–2 and, absent the application of §1.1446–6T (permitting a foreign partner to certify deductions and losses reasonably expected to be available to reduce the partner's U.S. income tax liability on the effectively connected income or gain allocable from the partnership), is not considered in computing the 1446 tax installment payment due on behalf of FC. Accordingly, 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 equals 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*—(i) *In general.* Except as provided in this paragraph (a)(2), in the case of a foreign partner that is a corporation for U.S. tax purposes, the applicable percentage is the highest rate of tax specified in section 11(b)(1) for such taxable year. Except as provided in this paragraph (a)(2) and §1.1446–5, in the case of a foreign partner that is not a corporation for U.S. tax purposes (*e.g.*, a partnership, individual, trust or estate), the applicable percentage is the highest rate of tax specified in section 1.

(ii) *Special types of income or gain.* Except as otherwise provided, a partnership is permitted to consider as the applicable percentage under this paragraph (a)(2) the highest rate of tax applicable to a particular type of income or gain allocable to a partner (*e.g.*, long-term capital gain allocable to a non-corporate partner, unrecaptured section 1250 gain, collectibles gain under section 1(h)), to the extent of a partner's allocable share of such income or gain. Consideration of the highest rate of tax applicable to a particular type of income or gain under the previous sentence shall be made without regard to the amount of such partner's income. A partnership is not permitted to consider the highest rate of tax applicable to a particular type of income or gain under this paragraph (a)(2)(ii) if the application of the preferential rate depends upon the corporate or non-corporate status of the person reporting the income or gain and, either no documentation has been provided to the partnership under §1.1446–1 to establish the corporate or non-corporate status of the partner required to pay tax on the income or gain, or the partnership is otherwise required to compute and pay 1446 tax on such portion of the income or gain using the highest applicable percentage under section 1446(b). See *e.g.*, §§1.1446–1(c)(3) (presumption of foreign status in the absence of documentation) and 1.1446–5(c)(2) (requirement to pay 1446 tax at higher of rates in section 1446(b) where a lower-tier partnership cannot reliably associate income with a partner of the upper-tier partnership).

(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 is 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 paragraphs (b)(2)(v) and (b)(3)(ii) of this section, in computing its first installment of 1446 tax for a taxable year, a partnership must decide whether it will pay its 1446 tax for the entire taxable year by using the safe harbor set forth in paragraph (b)(3)(i) 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 a partnership's underpayment of an installment of 1446 tax, the partnership shall be subject to an addition to the tax equal to the amount determined under section 6655, as modified by this section, as if such partnership were a 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's 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 of income, gain, loss and deduction are annualized to determine each foreign partner's allocable share of partnership ECTI under §1.1446–2. To the extent applicable, §1.1446–6T may be considered for purposes of this section to reduce the amount of the partner's allocable share of partnership ECTI to an amount that is subject to tax under section 1446. Each foreign partner's allocable share of partnership ECTI that is subject to tax under section 1446, or portion thereof, is then multiplied by the relevant applicable percentage for the type of income allocable to the foreign partner under paragraph (a)(2) of this section. The respective tax amounts are then added 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 subject to tax under section 1446 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. Therefore, the total amount of a partnership's 1446 tax installment payment is equal to the sum of the installment payments due for such period on behalf of all the partnership's foreign partners.

(ii) *Annualization methods.* A partnership that decides 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 (Section 1446).*"

(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.* If a partner's interest in the partnership terminates prior to the end of the partnership's taxable year, 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 1.1446–7 or incon-

sistent with those rules, the principles of section 6655 apply to the calculation of the installment payments of 1446 tax made by a partnership as set forth in this paragraph (b)(2)(v).

(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. This paragraph (b)(2)(v)(B) shall apply to 1446 tax paid by a partnership or nominee, as well as to amounts that a partner is deemed to have paid for estimated tax purposes by reason of the partnership's or nominee's 1446 tax payments under §1.1446–3(d)(1)(i).

(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, and any partnership required to pay such tax shall be treated as a corporation.

(F) *Application of section 6655(f)*. A partnership subject to section 1446 shall apply section 6655(f) after aggregating the 1446 tax due (or any installment of such tax) for all its foreign partners. See §1.1446–6T for an exception to this rule when a nonresident alien partner certifies to the partnership that the partnership investment is the nonresident alien partner's only activity giving rise to effectively connected items.

(G) *Application of section 6655(i)*. If a partnership has a taxable year of less than 12 months, the partnership is required to pay 1446 tax (including installments of such tax) in accordance with this section §1.1446–3, if the partnership has ECTI allocable under section 704 to foreign partners. In such a case, the partnership shall adjust its installment payments of 1446 tax in a reasonable manner (*e.g.*, the annualized amounts of ECTI estimated to be allocable to a foreign partner, and the section 6655(e)(2)(B)(ii) percentage to be applied to each installment) to account for the short-taxable year. However, if the partnership's taxable year is a period of less than 4 months, the partnership shall not be required to make installment payments of 1446 tax, but will only be required to file Forms 8804 and 8805 in accordance with this section §1.1446–3, and report and pay the appropriate 1446 tax for the short-taxable year.

(H) *Current year tax safe harbor*. The safe harbor set forth in section 6655(d)(1)(B)(i) shall apply to a partnership subject to section 1446.

(I) *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 (without regard to §1.1446–6T) 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)(ii), if a partnership decides to pay its 1446 tax for the first installment period based upon the safe harbor method set forth in paragraph (b)(3)(i), the partnership must use the safe harbor method for each installment payment made during the partnership's taxable year. Notwithstanding the previous sentence, 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 the tax under section 6655 (as applied through this section), 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 IRS 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 subject to the withholding requirements of sections 1441 and 1442 and the regulations thereunder.

(2) *Real property gains*—(i) *Domestic partnerships*. Except as otherwise provided in this paragraph (c)(2), 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)). A partnership that has complied with the requirements of section 1446 will be deemed to satisfy the withholding requirements of section 1445

and the regulations thereunder. However, a domestic partnership that would otherwise be exempt from section 1445 withholding by operation of a nonrecognition provision must continue to comply with the requirements of §1.1445–5(b)(2). In the event that amounts are withheld under section 1445(e) at the time of the disposition of a U.S. real property interest, such amounts may be credited against the partnership's 1446 tax. A partnership that fails to comply fully with the requirements of section 1446 pursuant to this paragraph (c)(2) shall be liable for any unpaid 1446 tax and subject to any applicable addition to the tax, interest, and penalties under section 1446. See §1.1446–4(f)(4) for rules coordinating the withholding liability of publicly traded partnerships under sections 1445 and 1446.

(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 amount 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 501(c) shall be required to pay 1446 tax on such ECTI only to the extent such ECTI is includible under section 512 and section 513 in computing the organization's unrelated business taxable income. The certificate procedure available under §1.1441–9(b)(1) by which a partner may set forth the amounts it believes will and will not be includible in its computation of unrelated business taxable income under section 512 and section 513 shall also apply to a partner in a partnership subject to section 1446. Such certificate shall be made by a partner in the same manner as under §1.1441–9(b)(2). A partnership that determines that the partner's certificate as to certain partnership items is unreliable or lacking must presume, consistent with §1.1441–9(b)(3) (regarding amounts includible under section 512 in computing the organization's unrelated business taxable income), that such partnership items would be includible in computing the partner's UBTI.

(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 ECTI allocable to 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 to that form. Form 8813 is generally used to transmit an installment payment of 1446 tax to the IRS with respect to partnership ECTI estimated to be allocated to foreign partners. However, see §1.1446–6T (relating to circumstances where a partnership must file Form 8813 when no payment is required under section 1446). Except as provided in this section, a partnership must notify each foreign partner of the 1446 tax paid on the partner's behalf when the partnership makes an installment payment of 1446 tax. The notice required to be given to a foreign partner under the previous sentence must be provided within 10 days of the installment payment due date, or, if paid later, the date such installment payment is made. A foreign partner generally may credit an installment of 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. See §1.1446–5(b) (relating to tiered partnership structures). However, a foreign partner may not obtain an early refund of such amounts under the estimated tax rules. See §1.1446–3(b)(2)(v)(B). See paragraph (d)(2) of this section for the amount of 1446 tax a partner may credit against its U.S. income tax liability. 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 (or prior year's safe harbor amount, if applicable), and the amount of tax paid on behalf of the partner for both the current and any prior installment periods during the partnership's taxable year. Notwithstanding any other provision of this paragraph (d), a withholding agent is not required to notify a partner of an installment of 1446 tax paid on the partner's behalf, unless requested by the partner, if—

(A) The partnership's agent responsible for providing notice pursuant to this paragraph is the same person that acts as an agent of the foreign partner for purposes of filing the partner's U.S. Federal income tax return for the partner's taxable year that includes the installment payment date; or

(B) The partnership has at least 500 foreign partners and the total 1446 tax that the partnership determines will be required to be paid for the partnership taxable year on behalf of such partner (based on paragraph (b)(2)(ii) or (3) of this section) with respect to the partner's allocable share of ECTI is less than $1,000.

(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. Installment 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 paragraph (d)(1)(iii) of 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 subject to §1.1446–4) 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(b)), must file Form 8804, "*An-*

nual 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*," for each of its foreign partners on whose behalf it paid 1446 tax, and furnish Form 8804 and the Forms 8805 to the Internal Revenue Service and the respective Form 8805 to each of its partners. Notwithstanding the previous sentence, a partnership that considers a foreign partner's certificate under §1.1446–6T when computing its 1446 tax on Form 8804 is required to furnish such partner and the Internal Revenue Service a Form 8805, even if the form submitted to the partner shows no payment of 1446 tax on behalf of the partner. 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.

(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 Internal Revenue Service 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 (as shown on Form 8805 to the 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 that includes the installment periods 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 pursuant to paragraph (d)(1)(iv) of this section, 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 the 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 generally 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. See paragraph (d)(1)(i) of this section regarding a partner's ability to credit an installment of 1446 tax paid on the partner's behalf against the partner's estimated tax payments due for the taxable year. See also §1.1446–5(b) (relating to tiered partnership structures).

(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) or (vii) of this section to be provided by such trust or estate and a copy of 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) *Special rules for apportioning the tax credit under section 33*—(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. The 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 of such trust or estate that includes the partnership ECTI allocated to the trust or estate in gross income under section 652 or section 662 (whether distributed or deemed to be distributed and with the same character as effectively connected income as in the hands of the trust or estate). In the case of a foreign trust or estate with multiple beneficiaries, each beneficiary may claim a portion of the 1446 tax that may be claimed by all beneficiaries under the previous sentence as a credit in the same proportion as the amount of ECTI included in such beneficiary's gross income bears to the total amount of ECTI included by all beneficiaries. 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 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 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 additions to the tax, interest, and penalties 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 knows or has reason to know that this paragraph (d)(2)(iii)(B) applies. A publicly traded partnership within the meaning of §1.1446–4 (or a nominee required to pay 1446 tax under §1.1446–4) will not be considered to know or have reason to know a domestic trust is being used to avoid the 1446 tax under this paragraph (d)(2)(iii)(B), provided the interest held in such entity by the domestic trust is publicly traded.

(iv) *Refunds to withholding agent.* A withholding agent (*i.e.*, the partnership) may obtain a refund of the 1446 tax paid (or deemed paid under §1.1446–5(b)) to the extent of the excess of the amount paid to the Internal Revenue Service by the partnership, over the partnership's section 1446 tax liability as determined by the sum of the total tax creditable to each partner indicated on all Forms 8805 for the taxable year. If a partnership issues Form 8805 to a partner, then the partnership may not claim a refund for any amount of tax shown on that form as paid on behalf of the partner. If a partnership incorrectly withholds upon a United States person under section 1446 of the Internal Revenue Code and issues a Form 8805 to that person, the partnership may not file for a refund of the amount incorrectly withheld. Instead, the United States person may file for a refund of that amount on its annual return. For rules concerning refunds to withholding agents who pay 1446 tax on distributions of effectively connected income or gain under §1.1446–4 (*i.e.*, publicly traded partnerships or nominees), see §1.1464–1.

(v) *1446 tax treated as cash distribution to partners.* Except as otherwise provided in this paragraph (d)(2)(v), a partnership's payment of 1446 tax on behalf of a foreign partner is treated under section 1446(d) and this section as a deemed distribution of money to the partner on the earliest of the day on which the partnership paid the tax, the last day of the partnership's taxable year for which the amount was paid, or the last day on which the partner owned an interest in the partnership during the taxable year for which the tax was paid. However, a deemed distribution of money under section 1446(d) resulting from a partnership's installment payment of 1446 tax on behalf of a partner is treated as an advance or drawing of money under §1.731–1(a)(1)(ii) to the extent of the partner's distributive share of income for the partnership taxable year. The rule treating a deemed distribution as an advance or drawing of money under this paragraph (d)(2)(v) applies only for purposes of determining the tax results of the deemed distribution to the partner under sections 705, 731, and 733, and does not affect the date that the partnership is considered to have paid any installment of 1446 tax for purposes of section 6655 (as applied through this section) or the date a foreign partner is deemed to have paid estimated tax by reason of such installment payment. See paragraph (d)(1)(i) of this section (permitting a partner to credit 1446 tax paid on the partner's behalf against the partner's estimated tax obligation). An amount treated as an advance or drawing of money is taken into account at the end of the partnership taxable year or the last day during the partnership's taxable year on which the partner owned an interest in the partnership. Any 1446 tax paid after the close of the partnership's taxable year, including amounts paid with the filing of Form 8804, that are on account of partnership ECTI allocated to partners for the prior taxable year shall be treated under section 1446(d) and this section as a distribution from the partnership on the earlier of the last day of the partnership's prior taxable year for which the tax is paid, or the last day in such prior taxable year on which such foreign partner held an interest in the partnership.

(vi) *Examples.* The following examples illustrate the application of this section. In considering the examples, disregard the potential application of paragraph (b)(2)(v)(F) of this section (relating to the *de minimis* exception to paying 1446 tax). The examples are as follows:

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. PRS and FT each maintain a calendar taxable year. PRS estimated for each installment period during the partnership's taxable year that FT would be allocated $100 of ECTI for the taxable year, and that all such ECTI would be ordinary in character. Assume that the allocation of the $100 would be respected under section 704(b) and the regulations thereunder. PRS pays installments of 1446 tax based upon its estimates and timely pays a total of $35 of 1446 tax over the course of the partnership's taxable year ($100 ECTI x .35). Assume that PRS' estimates of ECTI allocable to FT during the taxable year equal the actual amount of ECTI allocable to FT for the taxable year. Assume also that FT's only income for the taxable year is the $100 of income from PRS, and that, 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 as determined under paragraph (d)(2)(iii) of this section 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 PRS paid.

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 FT includes in its 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 $14 credit under section 33 for the 1446 tax PRS paid ($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 $21 credit under section 33 for the 1446 tax PRS paid ($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 FT includes in its 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). Pursuant to paragraph (d)(2)(iii) of this section, 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 $35 credit under section 33 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 1446 tax is made liable for that tax by section 1461. Therefore, a partnership that is required to pay 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, and to the extent, the partnership can demonstrate pursuant to paragraph (e)(2) of this section, to the satisfaction of the Commissioner or his delegate, that a foreign partner has paid the full amount of tax required to be paid by such partner to the Internal Revenue Service. See paragraph (e)(3) of this section and section 1463 regarding a partnership's liability for penalties and interest even though a foreign partner has satisfied the underlying tax liability. See also §1.1461–3 for applicable penalties when a partnership fails to pay 1446 tax. See paragraph (b) of this section for an addition to the tax under section 6655 when there is an underpayment of 1446 tax.

(2) *Proof that tax liability has been satisfied and deemed payment of 1446 tax.* Proof of payment of tax may be established for purposes of paragraph (e)(1) of this section consistent with §1.1445–1(e)(3). Under that standard, a partnership must provide sufficient information to the IRS to determine that the partner's tax liability was satisfied or established to be zero in accordance with the rules of this section. Under this section, a partnership's liability for 1446 tax shall be deemed to have been satisfied (deemed payment), to the extent of the 1446 tax due with respect to the ECTI allocable to a foreign partner, on the later of the date that such partner is considered to have paid all tax that is required to be shown on such partner's U.S. income tax return under section 6513(a) and (b)(2) (prescribing the date tax is considered paid for purposes of sections 6511(b)(2), (c), and 6512), or the last date for payment of the 1446 tax without extensions (the unextended due date for Form 8804). The deemed payment rule of this paragraph (e)(2) shall apply for purposes sections of 1446, 1461, and 1463, and any additions to the tax, interest, or penalties potentially applicable to such partnership under section 1446, including sections 6601, 6651, and 6655. Any deemed payment of 1446 tax under this paragraph (e)(2) shall not be treated as a deemed distribution under section 1446(d) and this section.

(3) *Liability for interest, penalties, and additions to the tax*—(i) *Partnership.* Notwithstanding paragraph (e)(2) of this section, a partnership that fails to pay 1446 tax is not relieved from liability under section 6655 (as applied through this section) or for interest under section 6601, when applicable. 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 the 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. The section 6601 interest charge shall accrue beginning on the last date prescribed for payment of the 1446 tax due under section 1461 (which is the due date, without extensions, for filing Form 8804). The section 6601 interest charge 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 (or is deemed satisfied under this paragraph (e)). Further, a partnership's liability under section 6655 (as applied through this section) for any underpaid installment payment shall accrue beginning on the relevant installment payment date, and shall stop accruing on the earlier of the date (and to the extent) that the 1446 tax liability is actually satisfied or the date prescribed in paragraph (b)(2)(v)(C) of this section. See paragraph (e)(4) of this section for examples illustrating that a partner's payment of estimated tax has no effect on the partnership's calculation of its addition to the tax under section 6655 and this section. See §1.1461–3 for a list of the additions to tax, interest, and penalties that may apply to a partnership that fails to comply with section 1446. See §1.1446–6T for exceptions to the application of the addition to the tax under section 6655 (as applied through this section) when a partnership reasonably relies on a foreign partner's certificate to reduce 1446 tax.

(ii) *Foreign partner.* A foreign partner is permitted to reduce any addition to the tax under section 6654 or section 6655 by the amount of any section 6655 addition to the tax paid by the partnership with respect to the partnership's failure to pay adequate installment payments of the 1446 tax on ECTI allocable to the foreign partner.

(4) *Examples.* The following examples illustrate the application of this section. In considering the examples, disregard the potential application of paragraph (b)(2)(v)(F) of this section (relating to the *de minimis* exception to paying 1446 tax). Further, in each of the examples where a partnership is deemed to have paid 1446 tax with respect to ECTI allocable to a partner, it is assumed that the partnership has presented to the IRS the appropriate information under paragraph (e)(2) of this section for the IRS to conclude that the deemed payment is appropriate. The examples are as follows:

Example 1. Foreign partnership fails to pay 1446 tax and sole foreign partner fails to pay all tax required to be shown on partner's U.S. income tax return.

(i) PRS is a foreign partnership engaged in a trade or business in the United States and has two equal partners, A, a U.S. person, and B, a nonresident alien. PRS is described in §1.6081–5(a) (PRS keeps its books and records outside the United States and

Puerto Rico) and, therefore, is required to file Form 8804 by the 15th day of the 6th month following the close of its taxable year. Both partners and PRS are calendar year taxpayers. PRS has received a valid Form W–9 and W–8BEN from A and B, respectively, but has not received any other documents or certificates. B is engaged in multiple trades or businesses (including the PRS partnership) that give rise to effectively connected income. PRS will use an acceptable annualization method under this section for computing its 1446 tax.

(ii) In PRS's first year of operations (Year 1), PRS estimates for each installment period described in §1.1446–3 that B will be allocated $100 of ordinary ECTI for the taxable year. Therefore, for each installment period PRS is required to pay one fourth of the tax on the annualized ECTI allocable to B, or $8.75 (.25 x ($100 x .35)). PRS fails to make any installment payments. PRS's operations actually result in $100 of ECTI allocated to B. Therefore, PRS was required to have paid 1446 tax of $35 on or before the due date, without extensions, for filing its Form 8804 which is June 15, Year 2 (the last date prescribed for payment of the 1446 tax). PRS does not file Forms 8804 or 8805.

(iii) B pays estimated taxes and makes the following payments on the following dates: June 15, Year 1 - $20, September 15, Year 1 - $15, and January 15, Year 2 - $10. B's total estimated tax payments equal $45. B files its U.S. Federal income tax return timely on June 15, Year 2, and reports all effectively connected income required to be shown on its return. Assume that B's total correct tax liability as shown on the return is $50. B does not make a payment with its return and so B still owes $5 to the Internal Revenue Service (excluding any interest, penalties, and additions to the tax that may apply). Assume that B is not subject to an addition to the tax under section 6654.

(iv) Under the rules of paragraph (e)(2) of this section, for purposes of sections 1446, 1461, and 1463, PRS is not considered to have paid any 1446 tax because B has not paid all of B's U.S. income tax liability.

(v) Further, under the principles of section 6655 and the rules of §1.1446–3(e), a partner's estimated tax payments will not affect the calculation of a partnership's addition to the tax. Accordingly, PRS will be liable under the principles of section 6655 and §1.1446–3 for failing to withhold for each installment payment. The addition to the tax will accrue beginning with the due date of each installment payment on the $8.75 underpayment for each respective installment period and will continue to accrue until June 15, Year 2 (the date prescribed in paragraph (b)(2)(v)(C) of this section).

(vi) Further, beginning on June 15, Year 2 (the last date prescribed for payment of 1446 tax without extensions), PRS will be liable for interest under section 6601 with respect to the unpaid 1446 tax, $35. This interest will stop accruing on the earlier of the date that the 1446 tax is paid by PRS or is deemed paid under paragraph (e)(2) of this section by reason of B's payment of its full tax liability.

(vii) Further, beginning on June 15, Year 2 (the due date for filing Form 8804), PRS will be liable for the addition to the tax under section 6651(a)(1) for failing to file Form 8804. This addition to the tax accrues on the amount required to be shown as the 1446 tax liability on Form 8804, $35. This addition to the tax will accrue at the rate of 5 percent per month until the date that PRS files Form 8804 for Year 1, or the maximum accrual of the penalty (25 percent of the tax required to be shown on the return) under that section has been reached.

(viii) PRS may be liable for other penalties and additions to the tax for its failure to withhold or to furnish statements to its foreign partner B. See §1.1461–3 for a list of the penalties that may apply.

Example 2. Foreign partnership fails to pay 1446 tax but sole foreign partner pays all tax required to be shown on the partner's U.S. income tax return. The facts are the same as *Example 1*, except that B pays $5 with the filing of B's return and has therefore paid all tax required to be shown on B's return within the meaning of paragraph (e)(2) of this section.

(i) For purposes of sections 1446, 1461, and 1463, PRS is deemed to have paid its 1446 tax liability under paragraph (e)(2) of this section as of the later of the date that B is considered to have paid its tax under section 6513(a) and (b)(2) (June 15, Year 2) and the last date for PRS to pay its 1446 tax without extensions (also June 15, Year 2). Therefore, PRS is deemed to have paid all of its 1446 tax liability as of June 15, Year 2. PRS has no continuing liability for 1446 tax under section 1461, however, additions to the tax, interest, and penalties may apply.

(ii) For purposes of section 6655 and §1.1446–3, under paragraph (e)(2) PRS is deemed to have paid its 1446 tax on June 15, Year 2. Even if B had fully paid its tax liability as of March 15, Year 2, the rule in paragraph (e)(2) of this section would not deem PRS to have paid its 1446 tax until June 15, Year 2. As a result, B's estimated tax payments will have no effect on PRS's calculation of its addition to the tax. The addition to the tax under 6655 and §1.1446–3 shall begin to accrue on each installment date with respect to the underpaid installment ($8.75), and will stop accruing on June 15, Year 2, the date prescribed in paragraph (b)(2)(v)(C) of this section.

(iii) Because PRS is deemed to have paid its full 1446 tax liability as of June 15, Year 2 (the last date prescribed for payment of 1446 tax without extensions), PRS is not subject to an interest charge under section 6601, or a failure to file penalty under section 6651 (see section 6651(b)(1)).

(iv) PRS may be liable for other penalties and additions to the tax for its failure to withhold or to furnish statements to its foreign partner B. See §1.1461–3 for a list of the penalties that may apply.

(v) If PRS had several foreign partners, PRS would conduct the same analysis as set forth above with respect to each partner. That is, under paragraph (e) of this section, PRS may be deemed to have paid 1446 tax with respect to the ECTI allocable to some but not all of its foreign partners.

Example 3. Domestic partnership fails to pay 1446 tax but sole foreign partner fully pays all tax required to be shown on partner's U.S. income tax return. The facts are the same as *Example 2*, except that PRS is a domestic partnership whose last date prescribed for paying 1446 tax without extensions (*i.e.*, generally the unextended due date for Form 8804) is April 15, Year 2.

(i) For purposes of sections 1446, 1461, and 1463, PRS is deemed to have paid its 1446 tax liability on the later of the date that B is considered to have paid tax under section 6513(a) and (b)(2) (June 15, Year 2) and the last date for paying 1446 tax without extensions (*i.e.*, the unextended due date for Form 8804, April 15, Year 2). Accordingly, PRS is not considered to have fully paid its 1446 tax liability until June 15, Year 2. PRS has no continuing liability for 1446 tax under section 1461, however, additions to the tax, interest, and penalties may apply.

(ii) For purposes of section 6655 and §1.1446–3, PRS is subject to an underpayment addition to the tax that accrues on the same amount as in *Example 1* and *Example 2* because PRS is not deemed to have paid 1446 tax under paragraph (e)(2) of this section until June 15, Year 2. The addition to the tax will stop accruing on the date prescribed in paragraph (b)(2)(v)(C) of this section (*i.e.*, April 15, Year 2, the due date, without extensions, for filing Form 8804).

(iii) For purposes of section 6601, as of the last date prescribed for paying 1446 tax without extensions (April 15, Year 2), PRS has not paid or been deemed to have paid any 1446 tax. Accordingly, the interest charge under section 6601 shall begin to accrue on April 15, Year 2, and shall accrue until the 1446 liability is paid or deemed to have been paid. In this case, the interest charge will accrue until June 15, Year 2, the date that PRS is deemed to have paid its 1446 tax under paragraph (e)(2) of this section.

(iv) For purposes of section 6651(a)(1), as of April 15, Year 2, PRS's amount required to be shown as tax on its Form 8804 is $35. This amount cannot be reduced under section 6651(b)(1) because PRS is not deemed to have paid 1446 tax under paragraph (e)(2) of this section until June 15, Year 2, a date falling after the last date for PRS to pay its 1446 tax, April 15, Year 2. Accordingly, the failure to file penalty will begin to accrue on April 15, Year 2 (filing due date for Form 8804), and shall stop accruing on the earlier of the date that PRS files Form 8804 or the maximum accrual of the penalty (25 percent of the amount required to be shown as tax on the return) is reached.

(v) PRS may be liable for other penalties and additions to the tax for its failure to withhold or to furnish statements to its foreign partner B. See §1.1461–3 for a list of the penalties that may apply.

(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 paragraph (d) of this section, 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. See §1.1446–3(e)(3)(ii) for rules permitting a partner to reduce its addition to tax under section 6654 or section 6655.

§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) of this section, and generally are not to pay over and report the 1446 tax under the rules in §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. For penalties and additions to the tax for failure to comply with this section, see §§1.1461–1 and 1.1461–3.

(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), except that the partnership or nominee required to pay 1446 tax may not consider a preferential rate in computing the 1446 tax due with respect to a partner.

(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. 78a). See paragraph (d) of this section regarding when a nominee is considered to have received a qualified notice.

(c) *Paying and reporting 1446 tax*. 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, as supplemented by the rules of this section. However, the reimbursement and set-off procedures set forth in §1.1461–2 shall not apply. A withholding agent under this section 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). Further, a withholding agent under this section may obtain a refund for 1446 tax paid in accordance with section 1464 and the regulations thereunder. See §1.1446–3(d)(1)(iv) and (vii) (relating to a foreign trust or estate that holds an interest in a publicly traded partnership) and §1.1446–5(d) (relating to a publicly traded partnership that is part of a tiered partnership structure) for additional guidance.

(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) received by the nominee. A nominee is treated as receiving a qualified notice at the time such notice is published in accordance with 17 CFR 240.10b–17(b)(1) or (3). Where a nominee is designated as a withholding agent with respect to a foreign partner of the partnership, 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 responsible for withholding under the rules of this section shall be subject to liability under sections 1461 and 6655, as well as all applicable penalties and interest, as if such nominee was a partnership responsible for withholding under this section.

(e) *Determining foreign status of partners*. 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. A partnership or nominee obligated to withhold under this section shall be entitled to rely on any of the forms acceptable under §1.1446–1 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.

(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. In the case of a partnership (upper-tier partnership) that receives a partnership distribution from another partnership in which it is a partner (lower-tier partnership)(*i.e.*, a tiered structure described in §1.1446–5), any 1446 tax that was paid by the lower-tier partnership may be credited by the upper-tier partnership and shall be treated as a distribution under section 1446. For example, a foreign publicly traded partnership, UTP, owns an interest in domestic publicly traded partnership, LTP. LTP makes a distribution subject to section 1446 of $100 to UTP during its taxable year beginning January 1, 2005, and withholds 35 percent (the highest rate in section 1) ($35) 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 with-

held by LTP against this liability as if it were paid by UTP. See §1.1462–1(b) and §1.1446–5(b)(1). 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 effectively connected with a U.S. trade or business, but not subject to withholding under section 1446 (*e.g.*, amounts exempt by treaty);

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

(iv) Amounts not listed in paragraphs (f)(3)(i) through (iii) 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) of the regulations; 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).

§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 a partnership (upper-tier partnership). Except as provided in paragraph (e) of this section, if an upper-tier domestic partnership directly owns an interest in a lower-tier partnership, the lower-tier partnership is not required to pay the section 1446 withholding tax (1446 tax) with respect to the upper-tier partnership's allocable share of net income, regardless of whether the upper-tier domestic partnership's partners are foreign. Paragraph (b) of this section prescribes the reporting requirements for upper-tier and lower-tier partnerships subject to section 1446. Paragraph (c) of this section prescribes rules requiring a lower-tier partnership to look through an upper-tier foreign partnership to a partner of such upper-tier partnership to the extent it has sufficient documentation to determine the status of such partner and determine such partner's indirect share of the lower-tier partnership's effectively connected taxable income (ECTI). Paragraph (d) of this section prescribes rules applicable to a publicly traded partnership in a tiered partnership structure. Paragraph (e) of this section prescribes rules permitting a domestic upper-tier partnership to elect to apply the look through rules of paragraph (c) of this section. Paragraph (f) of this section sets forth examples illustrating the rules of this section.

(b) *Reporting requirements*—(1) *In general*. Notwithstanding paragraph (c) of this section, 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 paid 1446 tax (including installment payments of such tax) with respect to ECTI allocable to the upper-tier partnership, the lower-tier partnership shall comply with §§1.1446–1 through 1.1446–3 and provide the upper-tier partnership notice of such payments and a copy of the statements and forms filed with respect to the upper-tier partnership's interest in the lower-tier partnership (*e.g.*, Form 8805, "*Foreign Partner's Information Statement of Section 1446 Withholding Tax*"). The upper-tier partnership may treat the 1446 tax (or any installment of such tax) paid by the lower-tier partnership on its behalf as a credit against its liability to pay 1446 tax (or any installment of such 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) and §1.1446–3(d). To the extent required in §1.1446–3(d)(1)(iii), the upper-tier partnership will file Form 8804, "*Annual Return for Partnership Withholding Tax (Section 1446)*," and Form 8805, "*Foreign Partner's Information Statement of Section 1446 Withholding Tax*," for each of its foreign partners with respect to its 1446 tax obligation. To the extent the upper-tier partnership does not claim a refund of the 1446 tax it paid (or is considered to have paid), the upper-tier partnership will pass the credit for the 1446 tax paid to its partners on the Forms 8805 it issues. See §1.1446–3(d). The rules of this paragraph (b) shall apply to an upper-tier and lower-tier partnership to the extent that an election has been made and consented to under paragraph (e) of this section.

(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. See also paragraph (d) of this section.

(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 foreign partnership owns an interest in the lower-tier partnership, the upper-tier partnership's allocable share of ECTI from the lower-tier partnership shall be treated as allocable to a partner of the upper-tier partnership, to the extent of such partner's indirect share of such ECTI (as if such partner were a direct partner in the lower-tier partnership), if—

(1) The upper-tier foreign partnership furnishes the lower-tier partnership 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)) effectively connected partnership items allocable to the upper-tier partnership (and indirectly to such partner) with a Form W–8 (*e.g.*, Form W–8BEN), Form W–9, "*Request for Taxpayer Identification Number and Certification*," or other form acceptable under §1.1446–1, establishing the status of such partner provided by the upper-tier partnership. 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 with a partner 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 a portion of the upper-tier partnership's allocable share of effectively connected partnership items with a partner of such upper-tier partnership, then the lower-tier partnership shall pay 1446 tax on such portion at the higher of the applicable percentages in section 1446(b). See §1.1446–3(a)(2) for the treatment of any income or gain potentially subject to a preferential rate. If a lower-tier partnership has not received a valid Form W–8IMY from the upper-tier partnership, the lower-tier partnership shall withhold on the upper-tier partnership's entire allocable share of ECTI at the higher of the applicable percentages in section 1446(b). The look through regime set forth in this paragraph (c) is for purposes of computing the lower-tier partnership's 1446 tax obligation only and does not alter the persons considered to be partners in the lower-tier partnership for partnership reporting purposes (*e.g.*, issuing Form 8805, Schedule K–1).

(d) *Publicly traded partnerships*—(1) *Upper-tier publicly traded partnership*. The rules set forth in paragraph (c) shall not apply to look through an upper-tier partnership whose interests are publicly traded (as defined in §1.1446–4(b)(1)).

(2) *Lower-tier publicly traded partnership*. The look through rules of paragraph (c) of this section shall apply, if the requirements of that paragraph are met, to a lower-tier partnership that is a publicly traded partnership within the meaning of §1.1446–4(b)(1) only if the upper-tier partnership is not described in paragraph (d)(1) of this section. For example, a lower-tier publicly traded partnership (or nominee) shall look through an upper-tier foreign partnership (or domestic partnership to the extent an election is made and consented to under paragraph (e) of this section) when computing its 1446 tax liability, provided the upper-tier partnership is not a publicly traded partnership and the appropriate documentation needed to satisfy the standards set forth in §1.1441–1(b)(2)(vii) and paragraph (c) of this section have been furnished.

(e) *Election by a domestic upper-tier partnership to apply look through rules*—(1) *In general*. Subject to the rules of this paragraph (e), a domestic partnership that is a partner in a lower-tier partnership may elect to apply the rules of this section 1.1446–5 and have the lower-tier partnership look through such upper-tier partnership to the partners of such domestic partnership for purposes of computing the lower-tier partnership's 1446 tax liability. A domestic partnership shall make this election by attaching to the Form W–9 submitted to the lower-tier partnership, a written statement and information (described in paragraph (e)(2) of this section) that identifies the upper-tier partnership as a domestic partnership and that states that such partnership is making the election under this paragraph (e). This paragraph (e)(1) shall not apply to a publicly traded partnership described in §1.1446–4(b)(1). See paragraph (d)(1) of this section.

(2) *Information required for valid election statement*. In addition to the requirements of paragraphs (e)(1) and (3) of this section, the election statement submitted under this paragraph (e)(2) is not valid and cannot be accepted by the lower-tier partnership pursuant to paragraph (e)(3) of this section unless the upper-tier partnership attaches valid documentation pursuant to §1.1446–1 (*e.g.*, Form W–8BEN) with respect to one or more of its foreign partners. The information and documentation submitted with the election must comply with the rules of this section to permit the lower-tier partnership to reliably associate (within the meaning of §1.1441–1(b)(2)(vii)) at least a portion of the upper-tier partnership's allocable share of ECTI with one or more foreign partners of the upper-tier partnership. The election statement must identify the upper-tier partnership by name, address, and TIN, and specify the percentage interest the domestic partnership holds in the lower-tier partnership. The statement may also include such information the upper-tier partnership deems necessary to enable the lower-tier partnership to apply the provisions of this section. If at any time the upper-tier partnership determines that the information or documentation previously provided to the lower- tier partnership is no longer correct, the upper-tier partnership shall update such information and documentation. Except as provided in paragraph (e)(3) of this section, an election that is effective under this paragraph (e) shall apply for subsequent taxable years until such upper-tier partnership revokes the election in writing. A revocation under this section shall be effective for any installment due date arising more than 15 days subsequent to the date that the lower-tier partnership receives such revocation.

(3) *Consent of lower-tier partnership*. An election made under this paragraph (e) is not effective until the lower-tier partnership consents in writing to the upper-tier partnership that it agrees to apply the provisions of this section. A lower-tier partnership may not consent to an election submitted under this paragraph (e) for any installment date or Form 8804 filing date arising within 15 days of the lower-tier partnership's receipt of such election. The lower-tier partnership's written consent must specify the extent to which it will look through the upper-tier partnership in computing its 1446 tax (or any installment of such tax). To the extent that the lower-tier partnership does not consent to an election to apply the look through provisions of paragraph (c) of this section, the lower-tier partnership shall consider such portion of the upper-tier partnership's allocable share of ECTI as allocable to a domestic person for purposes of computing its 1446 tax obligation. A lower-tier partnership that has consented to an election under this paragraph (e) may revoke or modify its consent, in writing, at any time.

(f) *Examples*. The following examples illustrate the provisions of this section. In considering the examples, disregard the potential application of §1.l446–3(b)(2)(v)(F) (relating to the *de minimis* exception to paying 1446 tax). The examples are as follows:

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. All of LTP'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. LTP has $100 of annualized ECTI for the relevant installment period. All of this income is ordinary income and there is no potential application of a preferential rate applicable percentage under §1.1446–3(a)(2). Further, §1.1446–6T does not apply. 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. The information that PRS submits to LTP is sufficient to permit LTP to reliably associate (within the meaning of §1.1441–1(b)(2)(vii)) PRS's allocable share of effectively connected items with NRA and FC pursuant to this section. 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 applicable percentage for non-corporate partners (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 40 percent allocable share ($40), or $28), LTP will pay 1446 tax on NRA's allocable share of LTP's 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 40 percent allocable share ($40), 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 (the highest rate in section 11).

(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 Forms 8805 that it files with the Internal Revenue Service pursuant to paragraph (b) of this section and will credit the amount withheld by LTP on its Form 8804. This credit will satisfy PRS's 1446 tax liability as reported on the Form 8804 it files because PRS's only income is from LTP, and LTP paid 1446 tax with respect to all of PRS's allocable share in LTP by looking through to PRS's partners NRA and FC. Further, PRS will pass along the credit for the 1446 tax withheld by LTP to its partners, NRA and FC on the Form 8805 issued to each partner. The credit passed to each partner on Form 8805 will be treated as a distribution to the respective partners under section 1446(d).

Example 2. Insufficient documentation—tiered partnership structure. (i) LTP is a domestic partnership that has two equal partners A and PRS. A is a nonresident alien and PRS is a foreign partnership that has two equal foreign partners, C and D. Neither A nor PRS provides LTP with a valid Form W–8 or Form W–9. Neither C nor D provides PRS with a valid Form W–8 or Form W–9. Pursuant to §1.1446–1(c)(3), LTP must presume that PRS is a foreign person subject to withholding under section 1446 at the higher of the highest rate under section 1 or section 11(b)(1). LTP has also not received any documentation with respect to A. LTP must presume that A is a foreign person, and, if LTP knows that A is an individual, compute and pay 1446 tax, subject to §1.1446–3(a)(2), based on that knowledge.

(ii) Assume a change of facts where C provides a form W–8 (*e.g.*, Form W–8BEN) to PRS, and PRS in turn, furnishes that form to LTP along with its Form W–8IMY, and information regarding how effectively connected items are allocated to C and D. Based upon the additional facts, LTP can reliably associate one-half of PRS's allocable share of ECTI with documentation related with C. Therefore, under paragraph (c)(2) of this section, LTP will look through PRS to C when computing its 1446 tax to the extent of C's indirect share and will not look through with respect to the remainder of PRS's allocable share (D's indirect share).

§1.1446–6T Special rules to reduce a partnership's 1446 tax with respect to a foreign partner's allocable share of effectively connected taxable income (Temporary).

(a) *In general*. The rules of this section describe when a partnership required to pay withholding tax under section 1446 (1446 tax), or any installment of such tax, may consider certain partner-level deductions and losses in computing its 1446 tax obligation under §1.1446–3, or otherwise may not be required to pay a *de-minimis* amount of 1446 tax with respect to a nonresident alien partner. A partnership determines the applicability of this section on a partner-by-partner basis for each installment period and when completing its Form 8804, "*Annual Return for Partnership Withholding Tax (Section 1446)*," and paying 1446 tax for the partnership taxable year. When applicable, the rules of this section permit a foreign partner to whom this section applies (within the meaning of paragraph (b) of this section) to furnish a certificate to the partnership that sets forth the deductions and losses that are connected with, or properly allocated and apportioned to, as the case may be, gross income that is effectively connected with the partner's U.S. trade or business and that such foreign partner reasonably expects to be available for the partner's taxable year to reduce the partner's U.S. income tax liability on the partner's allocable share of effectively connected income or gain from the partnership. The rules of this section also permit a partner to represent that the partner's investment in the partnership is (and will be) the partner's only investment or activity that will give rise to effectively connected items for the partner's taxable year. To apply the rules of this section, a partner must submit a new certificate for each partnership taxable year. Paragraph (c) of this section sets forth the deductions and losses that a partner may certify as reasonably expected to be available to such partner for the partner's taxable year, and sets forth rules regarding the partner's representation that the partnership investment is the partner's only activity giving rise to effectively connected items. Paragraph (c) of this section also sets forth requirements for a foreign partner's certificate to be valid. Paragraph (d) of this section provides rules regarding when a partnership may rely on and consider a foreign partner's certificate in computing its 1446 tax, and the effect of relying on such a certificate. Paragraph (d) of this section also provides rules regarding how a partnership must handle any certificate or updated certificate received pursuant to this section. Paragraph (e) of this section sets forth examples that illustrate the rules of this section.

(b) *Foreign partner to whom this section applies*—(1) *In general*. Subject to paragraph (b)(2) of this section, a foreign partner to whom this section applies is a foreign partner that has provided valid documentation to the partnership to whom a certificate is submitted under this section in accordance with §1.1446–1, has timely filed or will timely file a Federal income tax return in the United States in each of the partner's preceding four taxable years and the partner's taxable year(s) during which the certificate under this section is considered, and has timely paid (or will timely pay) all tax shown on such returns. This section shall not apply to a partner in a publicly traded partnership subject to §1.1446–4.

(2) *Special rules*. Notwithstanding paragraph (b)(1) of this section:

(i) In the case of a domestic or foreign partnership (upper-tier partnership) that is a partner in another partnership (lower-tier partnership), this section may apply to reduce or eliminate the 1446 tax (or any installment of such tax) of the lower-tier partnership with respect to a foreign partner of the upper-tier partnership only to the extent the provisions of §1.1446–5 apply to look-through the upper-tier partnership to the foreign partner of such upper-tier partnership and the certificate described in paragraph (c) of this section is provided by such foreign partner to the upper-tier partnership and, in turn, provided to the lower-tier partnership with other appropriate documentation. See §1.1446–5(c) and (e). Absent the application of §1.1446–5(c), the upper-tier partnership may not submit a certificate of deductions and losses to the lower-tier partnership.

(ii) This section shall not apply to a partner that is a foreign estate.

(iii) This section shall not apply to a partner that is a domestic or foreign trust, except to the extent that such trust is owned by a grantor or other person under subpart E of subchapter J of the Internal Revenue Code, the documentation requirements of §1.1446–1 have been met by the grantor or other owner of such trust, and the certificate described in paragraph (c) of this section is provided by the grantor or other owner of such trust to the partnership.

(c) *Certificate to reduce 1446 tax with respect to a foreign partner*—(1) *In general*. Subject to the rules of this section, a foreign partner may certify under paragraph (c)(1)(i) or (ii) of this section to a partnership for a partnership taxable year of such partnership that it has deductions and losses that the partner reasonably expects to be available to reduce the partner's U.S. income tax liability on the partner's allocable share of effectively connected income or gain from the partnership. Among other requirements, exceptions, and limitations set forth in paragraphs (c)(1)(i), (ii), and (iii) of this section, the foreign partner must generally represent that such deductions and losses have been (or will be) reflected on a timely filed U.S. income tax return of the partner for a taxable year that ends prior to the installment due date or Form 8804 filing date (without regard to extensions) for the partnership taxable year for which the certificate is considered (*i.e.*, no anticipated deduction or loss with respect to the partner's current year operations may be considered). A partner may also certify pursuant to paragraph (c)(1)(iv) of this section that the partner's only investment or activity giving rise to effectively connected items for the partner's taxable year is (and will be) the partner's investment in the partnership. A foreign partner's certificate to a partnership under this section must be in accordance with the form and requirements set forth in paragraph (c)(2)(ii) of this section.

(i) *Deductions and losses from the partnership from prior taxable years*. Under this section, a partner may certify that it has deductions and losses (certified deductions and losses), other than charitable deductions, from the partnership that the partner reasonably expects to be available to reduce the partner's U.S. income tax liability on the partner's allocable share of effectively connected income or gain from the partnership for the partner's taxable year. The certified deductions and losses must be reflected on a Schedule K–1 issued (or to be issued) to the partner by the partnership for a prior partnership taxable year. A partner that has a loss that is set forth on a Schedule K–1 the partnership issued for a prior year, but is not reflected on any of the partner's prior year returns because the loss is suspended under section 704(d) and, therefore, not deductible, may certify such loss to the partnership. Further, the foreign partner must certify that the deductions and losses are connected with (or, in the case of a corporate partner, allocated and apportioned to) gross income which is effectively connected (or treated as effectively connected) with the conduct of the partner's trade or business in the United States. In addition, the certificate must contain the information and representations set forth in paragraph (c)(2)(ii) of this section.

(ii) *Deductions and losses from sources other than the partnership from prior taxable years*. Under this section, a foreign partner may certify that it has deductions and losses, other than charitable deductions, from sources other than the partnership that the partner reasonably expects to be available to reduce the partner's U.S. income tax liability on the partner's allocable share of effectively connected income or gain from the partnership for the taxable year. The foreign partner must certify that the deductions and losses are connected with (or, in the case of a corporate partner, allocated and apportioned to) gross income which is effectively connected (or treated as effectively connected) with the conduct of the partner's trade or business in the United States. To the extent the deductions and losses certified under this paragraph (c)(1)(ii) arise from the partner's investment in another partnership, such deductions and losses must be reflected on a Schedule K–1 issued (or to be issued) to the partner by such other partnership for a prior taxable year of such other partnership that ends prior to the installment due date or Form 8804 filing date (without regard to extensions) of the partnership for the partnership taxable year for which the certificate is considered. Further, the partner may not certify to the partnership a loss suspended under section 704(d) from such other partnership. In addition, the certificate must contain the information and representations set forth in paragraph (c)(2)(ii) of this section.

(iii) *Limit on the consideration of a partner's net operating loss deduction*. A partnership may not consider a partner's net operating loss deduction certified under this section in an amount greater than 90 percent of the partner's allocable share of ECTI.

(iv) *Certificate of nonresident alien partner that partnership investment is partner's only activity giving rise to effectively connected items.* Under this section, a nonresident alien partner whose only activity giving rise to effectively connected income, gain, deduction, or loss for the partner's taxable year is (and will be) the partner's investment in the partnership, may certify this fact to the partnership. Except as otherwise provided in this paragraph (c)(1)(iv), a certificate submitted under this paragraph is generally subject to all of the applicable requirements and rules of this section (*e.g.*, the partner's preceding four years U.S. income tax returns are (or will be) timely filed, a new certificate is submitted for each partnership year, the time requirements for submitting the certificate are met, the certificate is signed under penalties of perjury). A partnership that receives a certificate from a nonresident alien partner under this paragraph (c)(1)(iv) is not required to pay 1446 tax (or any installment of such tax)

with respect to such partner if the partnership estimates that the annualized (or, in the case of a partnership completing its Form 8804, the actual) 1446 tax due with respect to such partner is less than $1,000. For purposes of computing the annualized or actual 1446 tax due with respect to such partner under the previous sentence, the partnership may not consider any of the partner's deductions and losses certified under paragraph (c)(1)(i) or (ii) of this section. In addition to the requirements of paragraph (c)(2) of this section, a nonresident alien partner must notify the partnership in writing and revoke its certificate submitted under this paragraph (c)(1)(iv) within 10 days of the date that the partner invests, or otherwise engages in, an activity that may give rise to effectively connected income, gain, deduction, or loss for the partner's taxable year. A partnership may reasonably rely on a partner's statement under the rules of paragraph (d) of this section and generally will be relieved of an addition to the tax under section 6655 as applied through this section, however, the partnership shall remain liable for the 1446 tax (or any installment of such tax), and any applicable additions to the tax (other than the addition to the tax under section 6655 as applied through this section), interest, and penalties under such paragraph, if the partner's certificate is later determined to be defective. The IRS may determine under the rules of this section, in its sole discretion, that the partner's certificate is defective within the meaning of paragraph (c)(3) of this section and notify the partnership in accordance with the rules of this section.

(2) *Time and form of certification*—(i) *Time for certification provided to partnership*—(A) *First certificate submitted for a partnership's taxable year*. Provided the other requirements of this section are met, the first certificate a foreign partner furnishes with respect to a partnership's taxable year shall not be relied upon for any installment due date, or Form 8804 filing due date (without regard to extensions), arising within 30 days of the date that the partnership receives such certificate. For example, a calendar year domestic partnership must generally receive a certificate under this section from a foreign partner on or before March 16th for the partnership to consider it for its first installment due date of 1446 tax on April 15th. If the foreign partner's first certificate for the partnership's current taxable year is received on April 10th, the partnership may not consider such certificate until the partnership's second installment due date of June 15th. See §1.1446–3 for 1446 tax installment due dates. See also paragraph (e) of this section for examples illustrating the rules of this paragraph (c)(2).

(B) *Updated certificates and status updates*—(*1*) *Foreign partner's prior year tax returns not yet filed*. If a foreign partner's U.S. Federal income tax return for a preceding taxable year has not been filed at the time that the partner submits its first certificate under this paragraph (c) to the partnership for a partnership taxable year, the partner shall specify this fact, set forth the filing due date for such return to the partnership in accordance with paragraph (c)(2)(ii) of this section, and submit an updated certificate in accordance with this paragraph (c) no later than 10 days after the date that the partner timely files its U.S. Federal income tax return for any such taxable year. If a prior year return has not been filed under the previous sentence, the partner shall provide the partnership a status update with respect to any unfiled prior year return, which must be received by the partnership at least 10 days prior to the partnership's final installment due date. The status update must be submitted under penalties of perjury and shall set forth the filing due date for any unfiled return identified in the first certificate and indicate whether the partner's first certificate submitted for the taxable year may continue to be considered. A status update shall apply only with respect to the timely filing of a partner's prior year tax returns. If the partnership does not receive an updated certificate (that includes the information required by this paragraph (c) for a status update) or a status update from the partner at least 10 days prior to the partnership's final installment due date, the partnership shall disregard the partner's certificate for the fourth installment period and when completing its Form 8804 for the taxable year and no additional certificate may be submitted or substituted for such disregarded certificate. Notwithstanding the previous sentence, if the partner can meet the requirements of this section for the next year, the partner may submit a certificate under this section.

(*2*) *Other circumstances requiring a foreign partner to submit an updated certificate*. Notwithstanding paragraph (c)(2)(i)(B)(*1*) of this section, if at any time the partner estimates that it reasonably expects to have available deductions and losses in an amount less than the corresponding amounts set forth on the most recent certificate furnished to the partnership for the partnership taxable year, then, within 10 days of such determination, the foreign partner shall submit an updated certificate under this paragraph (c) to the partnership. Similarly, if at any time the partner determines that its certificate is incorrect, other than by reason of the preceding sentence (*e.g.*, the character of a certified loss is capital rather than ordinary), then such partner shall update its certificate within 10 days of such determination.

(*3*) *Form and content of updated certificate*. The updated certificate required by this paragraph (c)(2)(i) must be submitted in the same form as the original certificate (described in paragraph (c)(2)(ii) of this section), and must include a caption at the top of the certificate, in lieu of the caption required by paragraph (c)(2)(ii), that states "UPDATED CERTIFICATE OF PARTNER-LEVEL ITEMS UNDER TEMP. REG. §1.1446–6T TO REDUCE SECTION 1446 WITHHOLDING." Further, the partner must attach a copy of the certificate that is being updated (superseded certificate) that was previously submitted for the same partnership taxable year.

(*4*) *When a partnership may consider an updated certificate*. A partnership may only consider an updated certificate that meets all the requirements of this paragraph (c) that it receives at least 10 days prior to an installment due date in the same partnership taxable year for which the superseded certificate was provided, or at least 10 days prior to the due date of its Form 8804 (without regard to extensions) to be filed for the year the superseded certificate was provided. An updated certificate that may be considered under the previous sentence supersedes all prior certificates submitted by the foreign partner for the same partnership taxable year, beginning with the installment period or Form 8804 filing date for which the partnership may consider the updated certificate. See §1.1446–6T(e) *Example 2*.

(ii) *Form of certification*. No particular form is required for the partner's certificate of deductions and losses to the partnership, but the partner's certificate must have a caption at the top of the page that reads: "CERTIFICATE OF PARTNER-LEVEL ITEMS UNDER TEMP. REG. §1.1446–6T TO REDUCE SECTION 1446 WITHHOLDING." Further, the certificate must include:

(A) The partner's name, address, Taxpayer Identification Number (TIN), and the date of the certification;

(B) The partnership's name, address, and TIN;

(C) The partnership taxable year for which the certificate is submitted;

(D) A representation that the partner is described in paragraph (b) of this section, and that the deductions and losses set forth in the certificate are described in paragraph (c)(1) of this section;

(E) The amount of the deductions and losses described in paragraph (c)(1) and, if applicable, the character of such deductions and losses (*e.g.*, capital or ordinary), as well as any particular deductions and losses that are subject to limitation or otherwise warrant special consideration (*e.g.*, suspended passive activity losses under section 469, suspended losses under section 704(d)), that the partner reasonably expects to be available to reduce the partner's U.S. income tax liability on the partner's allocable share of effectively connected income or gain from the partnership for the partner's taxable year in which such income or gain is includible in gross income;

(F) A representation that the deductions and losses described in paragraph (c)(1) and set forth in the certificate have been reflected on a timely filed U.S. income tax return, consistent with sections 874 and 882 of the Internal Revenue Code and the regulations thereunder (and such other provisions that impose requirements for the use of such deductions and losses);

(G) A representation that the deductions and losses described in paragraph (c)(1) and set forth in the certificate have not been set forth in a certificate provided to another partnership for the same taxable year for the purpose of reducing withholding under this section;

(H) A representation that the partner has timely filed, or will timely file its U.S. Federal income tax return for each of the preceding four taxable years and the partner's taxable year during which the certificate is considered, and has timely paid (or will timely pay) all tax shown on such returns as required under paragraph (b) of this section. The partner shall specify any taxable year for which a U.S. income tax return has not been filed as of the time of submission of the certificate, set forth the filing due date for such return, and represent that the partner will comply with the provisions of this paragraph (c) for providing an updated certificate or status update with respect to the filing of any such return;

(I) A representation that all of the deductions and losses described in paragraph (c)(1) (other than losses suspended under section 704(d)) and set forth in the certificate are (or will be) reflected on an income tax return of the partner that is filed (or will be filed) with respect to a taxable year of the partner that ends prior to the installment due date or Form 8804 filing due date (without regard to extensions) for the partnership taxable year for which such certificate will be considered;

(J) A representation that such deductions and losses described in paragraph (c)(1) and set forth in such certificate have not been disallowed by the IRS as part of a proposed adjustment described in §601.103(b) of this chapter (relating to examination and determination of tax liability) or §601.105(b) of this chapter (relating to examination of returns);

(K) A representation, when applicable (see paragraph (c)(1)(iv) of this section), that the partner's only activity that gives rise to effectively connected income, gain, deduction, or loss is (and will be) during the partner's taxable year the partner's investment in the partnership;

(L) The following statement: "Consent is hereby given to disclosures of return and return information by the Internal Revenue Service pertaining to the validity of this certificate to the partnership or other withholding agent to which this certificate is submitted for the purpose of administering section 1446." If a representative of the partner signs and dates the certificate under paragraph (c)(2)(ii)(M) of this section, a power of attorney specifically authorizing the agent to make the representation contained in this paragraph (c)(2)(ii)(L) must be attached to the certificate; and

(M) The signature of the partner, or its authorized representative, under penalties of perjury, and the date that the certificate was signed.

(3) *Notification to partnership when a partner's certificate cannot be relied upon*. Subject to paragraphs (c)(2), (c)(5), and (d)(2) of this section, a partnership may generally rely on a partner's certificate of available deductions and losses provided that the partnership does not have actual knowledge or reason to know that the certificate is defective within the meaning of this paragraph (c)(3). However, a partnership may not rely on a partner's certificate if the IRS determines, in its sole discretion, whether upon audit or otherwise, that a certificate submitted by a partner is defective, or that it lacks sufficient information to determine if the certificate is defective after written request to the partner for verification of the statements on the certificate. For example, a foreign partner's certificate is defective and, therefore, invalid if the IRS determines that the foreign partner has not timely filed a U.S. income tax return for a taxable year that the partner represented was or would be timely filed. See paragraph (e) *Example 3* of this section. If the IRS determines under this paragraph (c) that a certificate is defective (or lacks information sufficient to make this determination) and notifies the partnership in writing, the partnership may not rely on any certificate submitted by the partner for the partnership taxable year to which the defective certificate relates (or any subsequent partnership taxable year), until the IRS notifies the partnership again in writing and revokes or modifies the original notice. A partner's certificate of available deductions and losses is defective if—

(i) The partner is not described in paragraph (b) of this section;

(ii) The deductions and losses set forth in such certificate are not described in paragraph (c)(1) of this section;

(iii) The timing requirements for submitting certificates (including updated certificates and status updates) under paragraph (c)(2) of this section, or the requirements for submitting such updated certificates or status updates under such paragraph, are not observed;

(iv) The certificate does not include all of the information required by paragraph (c)(2)(ii) (*e.g.*, the partner's TIN is not set forth on such certificate);

(v) Any representation set forth in such certificate is incorrect (*e.g.*, a partner's

prior year return certified to have been timely filed was not timely filed, or, where applicable, that the partner is invested in or otherwise engaged in an activity (other than its investment in the partnership) that may give rise to effectively connected items); or

(vi) The actual deductions and losses available to the partner are less than the deductions and losses last certified to the partnership for the partnership taxable year and considered by the partnership.

(4) *Partner to receive copy of notice*. If the IRS notifies a partnership or withholding agent under this section that a certificate of a foreign partner is defective, the IRS shall also send a copy of such notice to the partner's address as shown on the certificate. The partnership shall promptly furnish the foreign partner whose certificate is the subject of the notice the copy of the notice received from the IRS.

(5) *Partner's certificate valid only for partnership taxable year for which submitted*. A partnership may only consider a certificate submitted under this paragraph (c) for the partnership taxable year for which the certificate is submitted, as set forth on the certificate. Therefore, for each year a partner wants the provisions of this section to apply, the partner must submit a new first certificate (as described in this paragraph (c)) for that year.

(d) *Effect of certificate of deductions and losses on partners and partnership*—(1) *Effect on partner*—(i) *No effect on substantive tax liability of foreign partner*. A foreign partner's submission of a certificate under this section to reduce or eliminate the partnership's 1446 tax (or any installment of such tax) with respect to ECTI allocable to such partner has no effect on the partner's substantive tax liability on the partner's allocable share of effectively connected income or gain from the partnership. Further, the submission of a certificate under this section does not constitute an acceptance by the IRS of the amount or character of the deductions or losses certified.

(ii) *No effect on partner's estimated tax obligations*. A foreign partner that certifies deductions and losses to a partnership under this section is not relieved of any estimated tax obligation otherwise applicable to such partner with respect to income or gain allocated from the partnership.

(2) *Effect on Partnership*—(i) *Reasonable reliance to relieve partnership from addition to the tax under section 6655*. Subject to §1.1446–2 and the rules of this section (*e.g.*, paragraph (c)(1)(iii) of this section), a partnership receiving a certificate (including an updated certificate or status update) of deductions and losses from a partner under this section may reasonably rely on such certificate (to the extent of the certified deductions and losses or other representations set forth in the certificate) for such time during which it has no actual knowledge or reason to know that the certificate is defective (within the meaning of paragraph (c)(3) of this section). To the extent a partnership has reasonably relied on a certificate under the preceding sentence, the partnership shall not be liable for any addition to the tax under section 6655 (as applied through §1.1446–3) for any period during which the partnership reasonably relied on such certificate, even if either it is later determined that the partner's certificate is defective or the partner submits an updated certificate under paragraph (c)(2) of this section that increases the 1446 tax due with respect to such partner. A partnership will not be considered to have actual knowledge or reason to know that a certificate is defective if the partnership receives an updated certificate that, pursuant to paragraph (c)(2)(i)(B)(*4*) of this section, the partnership cannot reasonably rely upon for an installment due date or Form 8804 filing date because it was received less than 10 days before such date. See paragraph (e) *Example 2* of this section.

(ii) *Filing requirement*. A partnership that relies in whole or in part on a partner's certificate pursuant to this section must file Form 8813, "*Partnership Withholding Tax Payment Voucher (Section 1446)*" or Forms 8804, "*Annual Return for Partnership Withholding Tax (Section 1446)*" and 8805, "*Foreign Partner's Information Statement of Section 1446 Withholding Tax*," whichever is applicable, for the period for which the certificate is considered, even if no 1446 tax (or an installment of such tax) is due with respect to such foreign partner. The partnership must also attach a copy of such certificate, and the partnership's computation of 1446 tax due with respect to such partner, to both the Form 8813 and Form 8805, filed with the IRS for any period for which such certificate is considered in computing the partnership's 1446 tax (or any installment of such tax). See §1.1446–3(d)(1)(iii) requiring the partnership to provide Form 8805 to such foreign partner even if no 1446 tax is paid on behalf of the partner.

(iii) *Continuing liability for withholding tax under section 1461 and for applicable interest and penalties*. Except as provided in paragraph (d)(2)(i) of this section and this paragraph (d)(2)(iii), a partnership is not relieved from liability for the 1446 tax under section 1461 or for any applicable addition to the tax, interest, or penalties if the partnership or the IRS, in its sole discretion, determines that a partner's certificate is defective (within the meaning of paragraph (c)(3) of this section), or the partner submits an updated certificate under paragraph (c)(2) of this section that increases the 1446 tax due with respect to such partner. If a certificate is determined to be defective for a reason other than the amount or character of the deductions and losses set forth on such certificate (*e.g.*, partner failed to timely file a U.S. income tax return), then the partnership shall be liable for the full 1446 tax under section 1461 (or any installment of such tax) due with respect to such partner, without regard to the certificate. However, see §1.1446–3(e) which deems a partnership to have paid 1446 tax with respect to ECTI allocable to a partner in certain circumstances. Further, if the partnership or the IRS, in its sole discretion, determines that a certificate is defective because the actual deductions and losses available to the partner are less than the amount certified to the partnership (other than when it is determined that the partner certified the same deduction or loss to more than one partnership), or that the character of the certified deductions and losses is erroneous, then the partnership shall be liable for 1446 tax under section 1461 (or any installment of such tax) with respect to such partner only to the extent it considers the certified deductions and losses in an amount greater than the amount determined to be actually available to the partner and permitted to be used under §1.1446–1 through §1.1446–6T, or to the extent that a mistake in the character of the deductions and losses results in an increase in the 1446 tax due with respect to such partner. See paragraph (e) *Example 4* of this section. Although a partnership is generally liable for

the 1446 tax, any addition to the tax, interest, and penalties under this paragraph (d)(2), the partnership may be relieved of some penalties in certain circumstances. See §§301.6651–(1)(c) and 301.6724–1 of this chapter. See also paragraph (e) *Example 3* of this section.

(iv) *Partner's certified deductions and losses to offset foreign partner's annualized allocable share of partnership ECTI.* For purposes of section 1446, when considering a foreign partner's certificate submitted under this section in computing the 1446 tax due (or any installment of such tax) with respect to the foreign partner, a partnership shall first annualize the partner's allocable share of the partnership's effectively connected items of income, gain, deduction, and loss before considering the partner's certified deductions and losses.

(e) *Examples.* The following examples illustrate the application of this section. In considering the examples, disregard the potential application of §1.1446–3(b)(2)(v)(F) (relating to the *de minimis* exception to paying 1446 tax) and paragraph (c)(1)(iv) of this section (relating to a foreign partner whose sole investment generating effectively connected income or gain is the partnership), and assume, where necessary, that the election to apply the temporary regulations is made. The examples are as follows:

Example 1. General application of the rules of §1.1446–6T. NRA, a nonresident alien, and B, a U.S. person form a partnership, PRS, to conduct a trade or business in the United States. NRA and B are equal partners under the partnership agreement and the partnership, NRA, and B all maintain a calendar taxable year. NRA and B provide PRS with a valid Form W–8BEN and Form W–9, respectively. Prior to the formation of PRS, NRA had neither invested in, nor been considered to be engaged in a U.S. trade or business. In each of years 1, 2, and 3, PRS incurs a $1,000 net loss from operations which is allocated equally to NRA and B. Assume the net loss is not a passive activity loss within the meaning of section 469, is comprised entirely of ordinary items and, with respect to NRA, is an effectively connected net loss. Further, assume that NRA has timely filed U.S. Federal income tax returns for each of the first three years reflecting the losses allocated from PRS, as reflected on the Schedule K–1 issued to NRA for each of those years.

(i) With respect to Year 4, NRA may not submit a certificate under paragraph (c) of this section to PRS because NRA has not and will not have timely filed a U.S. Federal income tax return for the preceding four years. That is, during Year 4, NRA can only certify that it has or will timely file its U.S. Federal income tax returns for the preceding three years (Years 1 through 3) and the current year, Year 4. Therefore, with respect to Year 4, PRS may not use the procedures in this section to reduce its withholding tax.

(ii) Assume that in Year 4, PRS has net income of $1,000 from its U.S. business operations and that all of such income is comprised of ordinary items. NRA's allocable share of this income is $500 and such income is effectively connected income. PRS satisfies its 1446 tax obligations for Year 4.

(iii) During Year 5, PRS uses an acceptable annualization method under §1.1446–3 and estimates for its first installment period that it will earn $4,000 of taxable income for the taxable year. Assume that all of this income is ordinary in character and is allocable to NRA and B equally. NRA's allocable share of $2,000 is NRA's share of partnership ECTI. NRA has not yet filed its income tax return for Year 4, although NRA has received the Schedule K–1 issued by PRS pertaining to Year 4. On or before March 16th (at least 30 days prior to the first installment date) of Year 5, PRS receives a certificate described in this section from NRA which certifies that NRA reasonably expects to have available ordinary losses of $1,000 ($500 loss in each of Years 1, 2, and 3 less $500 of income in Year 4). Further, NRA makes all of the statements and representations required for the certificate to be valid.

(iv) With respect to Year 5, and based upon paragraph (b)(1) of this section, NRA can include Year 4 (NRA's preceding taxable year) as one of the preceding four years that it has timely filed or will timely file its U.S. Federal income tax return (and timely paid or will timely pay all tax shown on such returns). Therefore, provided PRS has no actual knowledge or reason to know the certificate is defective, PRS may reasonably rely on NRA's certificate. Accordingly, PRS may consider NRA's certificate to reduce the amount that would otherwise be required to be paid on NRA's behalf under section 1446. Specifically, the $1,000 of net losses that have been reflected on Schedule K–1s issued to NRA that are available to reduce NRA's U.S. income tax on NRA's allocable share of effectively connected income or gain allocable from PRS may be used to reduce the $2,000 of ECTI estimated to be allocable to NRA. As a result, PRS must pay 1446 tax on only $1,000 of NRA's allocable share of partnership ECTI for the first installment period in Year 5. PRS must pay 1446 tax of $87.50 for its first installment period with respect to the ECTI allocable to NRA ($1,000 (net ECTI after considering certified losses) x .35 (withholding tax rate) x .25 (§6655(e)(2)(B) percentage for first installment)). Pursuant to paragraph (d)(2) of this section, PRS must also attach NRA's certificate and PRS's computation of its 1446 tax obligation with respect to NRA to its Form 8813, "Partnership Withholding Tax Payment Voucher (Section 1446)," filed for the first installment period. Under paragraph (c)(2)(i)(B), NRA is required to update its certified available losses on or before the 10th day after NRA files its U.S. Federal income tax return for Year 4, even if the updated certificate results in no change to the deductions and losses certified.

(v) The result in this example is the same even if NRA had not yet received a Schedule K–1 from PRS for Year 4. In such case, NRA is still permitted to certify the losses that it reasonably expects to be available for Year 5, and certify that it will timely file its U.S. Federal income tax return for Year 4 and Year 5 (and timely pay all U.S. income tax due).

Example 2. Updated certificate submitted for losses. On January 1, 2005, NRA, a foreign individual, and B, a U.S. individual, form a domestic partnership, PRS, to conduct a business in the United States, with NRA and B as equal partners in PRS. NRA and B provide a valid Form W–8BEN and Form W–9, respectively, to PRS. NRA, B, and PRS all maintain a calendar taxable year. For the preceding seven calendar taxable years (1998–2004), NRA has been engaged in a U.S. trade or business through its investment in another partnership, XYZ, and timely filed its Form 1040NR U.S. Federal income tax return reporting its share of XYZ's activity for each of years 1998–2003 (and timely paid all tax shown on such returns). NRA also timely files its income tax return for the 2004 taxable year (and timely pays all tax shown on such return) on June 8, 2005 (due date June 15, 2005). During the taxable years 1998–2004, NRA's only activity generating effectively connected items was its investment in XYZ. Assume that the losses that XYZ allocated to NRA are not considered passive activity losses to NRA within the meaning of section 469. The XYZ partnership liquidated and ceased doing business on December 31, 2004. Assume that PRS uses an acceptable annualization method under §1.1446–3 for purposes of section 1446.

(i) On or before March 16, 2005, NRA provides and PRS receives a valid certificate under this section in which NRA certifies that it reasonably expects to have available effectively connected net operating losses in the amount of $5,000. Among other statements made in accordance with paragraph (c) of this section, NRA represents that it has not filed its 2004 U.S. income tax return, but will timely file such return (and timely pay all tax shown on such return). PRS reasonably relies on such certificate within the meaning of paragraph (d) of this section. For its first installment period in 2005, PRS estimates that it will earn taxable income of $10,000 for the year which will be allocated equally to NRA and B (NRA's allocable share of $5,000 is considered NRA's share of partnership ECTI). Assume that all of this income is ordinary in character.

(ii) Under these facts, PRS may consider NRA's certified available losses when computing its 1446 tax obligation for the first installment period. PRS is limited under paragraph (c)(1)(iii) of this section and may consider only $4,500 of NRA's certified net operating loss. After consideration of the certified loss, PRS owes 1446 tax in the amount of $43.75 for the first installment period ($5,000 estimated allocable ECTI less $4,500 (certified loss as limited under paragraph (c)(1)(iii)) x .35 (1446 tax applicable percentage) x .25 (section 6655(e)(2)(B) percentage for first installment period). Pursuant to paragraph (d)(2) of this section, PRS must file Form 8813 with respect to NRA, and attach to the form a copy of NRA's certificate and PRS's computation of its 1446 tax obligation.

(iii) Assume that PRS's estimates of its net income allocable to NRA for the second and third installment periods are the same as for the first installment period (*i.e.*, NRA's allocable share of annualized ECTI is $5,000), and that on June 10, 2005, PRS receives an updated certificate under this section from NRA that certifies that NRA reasonably expects to

have only $4,000 of losses available to reduce NRA's income tax liability on NRA's allocable share of the effectively connected income or gain from PRS. NRA provided this certificate within 10 days of filing its U.S. Federal income tax return for the 2004 taxable year, as required by paragraph (c) of this section. However, PRS received the updated certificate less than 10 days before its second installment due date (June 15, 2005) and, under paragraph (c)(2)(i)(B) of this section, is not permitted to reasonably rely on the updated certificate for the second installment period. Notwithstanding that the updated certificate indicates to PRS that NRA's certified losses are less than the $5,000 set forth on NRA's first certificate, under paragraph (d)(2) of this section, PRS will not be considered to have actual knowledge or reason to know that the first certificate is defective for the second installment period. Provided the updated certificate is otherwise valid, it may be relied upon for the third installment period (due date September 15, 2005).

(iv) Under paragraph (d) of this section, PRS may reasonably rely on all or a portion of NRA's first certificate for the second installment period. That is, PRS may consider all $4,500 of NRA's certified losses, as limited by paragraph (c)(1)(iii) of this section, or some lesser amount (*e.g.*, only $4,000) for the second installment period. Further, if PRS considers NRA's first certificate for the second installment period, PRS must file Form 8813 and attach the certificate it reasonably relied upon for the second installment period. Assume that PRS considers $4,500 of the net operating losses for the second installment period, as limited by paragraph (c)(1)(iii) of this section, and therefore makes a 1446 tax payment of $43.75 on behalf of NRA.

(v) Under paragraph (d) of this section, PRS is not relieved from its liability for 1446 tax under section 1461 when it accepts a certificate of losses from a foreign partner and it is later determined that the certificate is defective, or the partner updates its certificate and represents losses in an amount less than previously certified. Under the principles of section 6655 (as applied through §1.1446–3), PRS is required to have paid in 75 percent of the annualized 1446 tax on or before the third installment payment date (section 6655(e)(2)(B) percentage for third installment period). Under paragraph (c)(2)(i)(B) of this section, because NRA's updated certificate is valid for the third installment period, if PRS considers any certificate for that period it must consider the updated certificate. Assuming PRS considers NRA's updated certificate for the third installment period, PRS must have paid a total of $262.50 with respect to the ECTI estimated to be allocable to NRA as of the third installment due date ($1,000 (ECTI subject to 1446 tax after considering the $4,000 of certified losses on the updated certificate) x .35 (withholding tax rate) x .75 (section 6655(e)(2)(B) percentage for the third installment period)). After considering PRS's payments of 1446 tax for the first and second installment periods, PRS is required to pay $175 for the third installment period ($262.50 less previous payments totaling $87.50).

(vi) Under paragraph (d) of this section, PRS is not liable for the addition to the tax under section 6655 (as applied through §1.1446–3) for the first or second installment period because PRS reasonably relied on NRA's certificate of losses during those periods.

Example 3. IRS determines in subsequent taxable year that partner's certificate is defective because partner failed to timely file an income tax return. NRA, a foreign individual, and B, are the only partners in PRS, a domestic partnership that conducts a trade or business in the United States. Each partner provides appropriate documentation under §1.1446–1 (*e.g.*, Form W–8BEN, Form W–9) to establish the partner's status for purposes of section 1446. Both partners and the partnership maintain a calendar taxable year. NRA timely submits a certificate under this section to PRS to be considered for PRS's first installment period in the 2005 taxable year. The certificate sets forth that NRA reasonably expects to have $5,000 of an effectively connected net operating loss available to offset effectively connected income or gain allocable from PRS for the 2005 taxable year. No part of this loss is a passive activity loss within the meaning of section 469. NRA is eligible to submit this certificate under paragraph (b) of this section and the certificate complies with all necessary requirements set forth in this section. PRS estimates for each installment period that NRA's allocable share of ECTI will be $5,000. Further, PRS's actual operating results for the year result in $5,000 of ECTI allocable to NRA.

(i) PRS reasonably relies on (within the meaning of paragraph (d)(2) of this section) NRA's certificate when computing each installment payment during the 2005 taxable year and its 1446 tax on Form 8804, and appropriately considers the limitation set forth in paragraph (c)(1)(iii) of this section. As a result, PRS paid a total of $175 of 1446 tax on behalf of NRA for the taxable year ($5,000 allocable share of ECTI - $4,500 losses permitted to be considered under paragraph (c)(1)(iii) of this section x .35 applicable percentage). As required under paragraph (d) of this section, PRS attached the certificate it relied upon and its calculation of 1446 tax for each period to the Form 8813 or Form 8805 it filed for such period with the IRS.

(ii) Assume that NRA timely submits a certificate under this section to be considered for PRS's first installment due date of the 2006 taxable year (due date April 17, 2006). The certificate represents that NRA reasonably expects to have $5,000 of an effectively connected net operating loss available to offset effectively connected income or gain allocated from PRS for the 2006 taxable year. No part of this loss is a passive activity loss within the meaning of section 469. Further, the certificate contains all of the necessary representations required under this section. For the first installment period of 2006, PRS estimates that NRA's allocable share of partnership ECTI is $5,000. Assume all of the estimated ECTI is ordinary in character and, pursuant to paragraph (d)(2) of this section, PRS reasonably relies on NRA's certificate for the first installment period and appropriately determines that it is required to make an installment payment of 1446 tax on behalf of NRA in the amount of $43.75 ($5,000 estimated allocable ECTI less $4,500 (certified loss as limited under paragraph (c)(1)(iii) of this section) x .35 (1446 tax applicable percentage) x .25 (section 6655(e)(2)(B) percentage for first installment period). PRS makes the $43.75 installment payment of 1446 tax with the Form 8813 it files for the first installment period, and complies with paragraph (d)(2) of this section and attaches NRA's certificate and PRS's computation of 1446 tax to its Form 8813.

(iii) Assume that the IRS notifies the partnership on June 1, 2006, pursuant to paragraph (c)(3) of this section, that NRA's certificate for PRS's 2005 taxable year is defective because NRA failed to timely file its U.S. Federal income tax return for one of the taxable years that NRA represented was (or would be) timely filed (*e.g.*, 2001, 2002, 2003, or 2004). The IRS notice states that PRS is not to rely on any certificate that NRA has submitted for the 2006 taxable year.

(iv) Under paragraph (d)(2)(iii) of this section, PRS is not relieved from its liability for 1446 tax under section 1461 when it accepts a certificate of losses from a foreign partner and it is later determined that the certificate is defective. Because NRA's certificate was determined to be defective for a reason other than the amount or character of the certified deductions and losses, PRS is fully liable for the 1446 tax due with respect to NRA's allocable share of partnership ECTI for the 2005 taxable year without regard to the certificate. The total 1446 tax due for 2005 is $1,750 ($5,000 ECTI x .35) and PRS has paid $175 of this liability. Therefore, PRS owes $1,575 of 1446 tax. However, PRS may be deemed to have paid the outstanding 1446 tax due if NRA has paid all of its tax. See §1.1446–3(e).

(v) Because PRS neither had actual knowledge nor reason to know that the certificate submitted by NRA was defective, PRS reasonably relied on NRA's certificate for the 2005 taxable year under paragraph (d)(2) of this section. Therefore, PRS is not liable for an underpayment addition to the tax under the principles of section 6655 (as applied through §1.1446–3) for any installment period during the 2005 taxable year.

(vi) However, PRS is generally liable for interest under section 6601 and for the failure to pay penalty under section 6651(a)(2) on the $1,575 of 1446 tax due for the 2005 taxable year from April 17, 2006 (last date prescribed for payment of 1446 tax), to the date that the partnership pays the 1446 tax or is deemed to have paid such tax under §1.1446–3(e).

(vii) With respect to the 2006 taxable year, PRS reasonably relied on NRA's certificate when computing its first installment payment for the 2006 taxable year (due on April 17, 2006). Therefore, PRS will not be liable for the underpayment addition to the tax under section 6655 (as applied through §1.1446–3) for the first installment period in 2006. However, because PRS was notified on June 1, 2006, to disregard any certificate received from NRA for the 2006 taxable year, PRS may not rely on NRA's certificate (or any new certificate provided by NRA) when PRS computes its second installment payment of 1446 tax due on June 15, 2006. PRS is not permitted to consider any certificate submitted by NRA under this section until the IRS notifies the partnership again in writing and revokes or modifies the original notice.

Example 4. IRS determines in subsequent taxable year that partner's certificate is defective because partner's actual losses are less than amount certified and considered by the partnership. Assume the same facts as in *Example 3*, except that the IRS does not determine that NRA's certificate for 2005 was defective because NRA failed to timely file a U.S. income tax return for a prior year. Rather, the IRS determines that NRA's certificate was defective for the 2005 taxable year because NRA's actual available net operating loss for the taxable year was $1,000, not the $5,000 amount that was certified. In *Example 3*, pur-

suant to paragraph (c)(1)(iii) of this section, PRS considered $4,500 of the certified loss in each installment period and when completing Form 8804.

(i) Under paragraph (d)(2)(iii) of this section, PRS is not relieved from its liability for 1446 tax under section 1461 when it accepts a certificate of losses from a foreign partner and it is later determined that the certificate is defective. However, when the IRS determines that a partner's certificate is defective because of the amount or character of the certified deductions and losses set forth on such certificate, the partnership is only liable for the 1446 tax, interest, and penalties to the extent it considered the certified deductions and losses on such certificate when computing its 1446 tax (or any installment of such tax) in an amount greater than the partner's actual available losses. Here, PRS considered the certified deductions and losses in the amount of $4,500. It was later determined that NRA only had $1,000 of actual losses. Accordingly, PRS is liable for the 1446 tax due with respect to the portion of the overstated losses that it considered when computing its 1446 tax. The remaining 1446 tax due for 2005 is $1,225 ($3,500 of excess losses considered x .35). However, PRS may be deemed to have paid the $1,225 of 1446 tax under §1.1446–3(e) if NRA has paid all of NRA's U.S. income tax.

(ii) If PRS had considered only $1,000 of NRA's certified net operating loss when computing and paying its 1446 tax during the 2005 taxable year then, under paragraph (d)(2)(iii) of this section, PRS would not be liable for 1446 tax because it did not consider the certified deductions and losses in an amount greater than the amount determined to be actually available to the partner.

Example 5. Partner with different taxable year than partnership. PRS partnership has two equal partners, FC, a foreign corporation, and DC, a domestic corporation. PRS conducts a trade or business in the United States and generates effectively connected income. FC maintains a June 30 fiscal taxable year end, while DC and PRS maintain a calendar taxable year end. FC and DC provide a valid Form W–8BEN and Form W–9, respectively, to PRS. PRS uses an acceptable annualization method under §1.1446–3 in computing its 1446 tax. FC and DC are the only persons that have ever been partners in PRS. For its 2000 through 2004 taxable years, PRS issued Schedule K–1s to each of its partners. In the aggregate, the Schedule K–1s passed through $100 of net ordinary loss to each partner. For its 2005 taxable year, PRS issued Schedule K–1s to its partners passing through $150 of ordinary loss to each partner. All of the losses passed through on the Schedule K–1s are effectively connected to PRS's and FC's trade or business in the United States.

(i) Assume that all the requirements of this section have been met to permit FC to certify losses to the partnership for the partnership's 2006 taxable year. Further, assume that FC's only source of effectively connected income, gain, deduction, or loss is the activity of PRS.

(ii) For PRS's first installment period in 2006, FC may only certify deductions and losses under this section in the amount of $100 (the losses as reflected on the Schedule K–1s issued for PRS's 2000–2004 taxable years). Under section 706, the taxable income of a partner shall include the income, gain, loss, deduction, or credit of the partnership for the partnership taxable year ending within or with the taxable year of the partner. PRS's 2005 calendar taxable year ends during FC's fiscal taxable year ending June 30, 2006. Therefore, under paragraph (c)(1) of this section, as of March 18, 2006 (the last date FC may submit its first certificate under paragraph (c) to have it considered for PRS's first installment due date of April 17, 2006), the losses passed through from PRS for the 2000–2004 partnership taxable years will be the only losses that FC can represent will be reflected on an FC U.S. income tax return filed for a taxable year ending prior to such installment due date.

(iii) The result in (ii) is the same for the second installment period, the due date of which is June 15, 2006.

(iv) FC may submit an updated certificate under this section after June 30, 2006, that includes the 2005 Schedule K–1 loss in the amount of $150. PRS may consider such an updated certificate for its third installment period (due date September 15, 2006), provided the updated certificate is received in accordance with paragraph (c) of this section, by September 5, 2006.

Example 6. Failure to provide status update with respect to prior year unfiled returns. PRS partnership has two equal partners, FC, a foreign corporation, and DC, a domestic corporation. Both partners and PRS maintain calendar taxable years. PRS is engaged in a trade or business in the United States. FC and DC provide Form W–8BEN and Form W–9, respectively, to establish each partner's status for purposes of section 1446. Assume all partnership items allocated from the partnership arise from the partnership's trade or business in the United States and, therefore, FC's allocable share of these items is considered effectively connected.

(i) Assume FC is eligible to submit a certificate under this section and submits a certificate at least 30 days prior to PRS's first installment due date. FC represents that it has or will timely file an income tax return in the United States in each of the preceding four taxable years (and has timely paid or will timely pay all tax shown on such returns). FC specifies that it has not filed its U.S. income tax return for the immediately preceding taxable year. FC also represents that it will timely file its U.S. income tax return for the partner taxable year during which the certificate is considered (and will timely pay all tax shown on such return). All other requirements under paragraph (c) of this section are met for FC's certificate to be valid.

(ii) Provided that PRS does not possess actual knowledge or reason to know that FC's certificate is defective, and an updated certificate is not provided to PRS, under paragraph (d) of this section, PRS may reasonably rely on FC's certificate for its first, second, and third installment payments.

(iii) If FC does not submit either an updated certificate or a status update as required by paragraph (c) of this section with respect to the filing of the previous year's income tax return by December 5th of PRS's current taxable year, PRS must disregard FC's certificate when computing its fourth installment payment of 1446 tax and when completing its Form 8804 for the taxable year. Further, even if the status update with respect to the preceding year's return is provided, PRS may only rely on the certificate provided the status update does not contradict the certificate and such update indicates that the preceding year's return may still be, and will be, timely filed.

(f) *Effective dates*. The rules of this section are applicable for partnership taxable years beginning after May 18, 2005. However, a partnership may elect to apply all of the provisions of the temporary regulations to partnership taxable years beginning after December 31, 2004, provided the partnership also elects under §1.1446–7 to apply §§1.1446–1 through 1.1446–5 to partnership taxable years beginning after December 31, 2004. A partnership shall make the election under this section by complying with the provisions of this section and attaching a statement to the Form 8804 annual return filed for the taxable year in which the regulation provisions first apply, that indicates that the partnership is making the election under this section and §1.1446–7.

§1.1446–7 Effective dates.

Sections 1.1446–1 through 1.1446–5 shall apply to partnership taxable years beginning after May 18, 2005. However, a partnership may elect to apply all of the provisions of §§1.1446–1 through 1.1446–5 to partnership taxable years beginning after December 31, 2004. A partnership shall make the election under this section by complying with the provisions of §§1.1446–1 through §1.1446–5 and attaching a statement to the Form 8804 or Form 1042 annual return, filed for the taxable year in which the regulation provisions first apply, that indicates that the partnership is making the election under this section.

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. 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. The previous two sentences shall apply to partnership taxable years beginning after May 18, 2005, or such earlier time as the regulations under §§1.1446–1 through 1.1446–5 apply by reason of an election under §1.1446–7.

* * * * *

(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) (applicable to publicly traded partnerships required to pay tax under section 1446 on distributions) 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 May 18, 2005, or such earlier time as the regulations under §§1.1446–1 through 1.1446–5 apply by reason of an election under §1.1446–7.* * *

(ii) * * *

(A) * * *

(*8*) A partner receiving a distribution from a publicly traded partnership subject to withholding under section 1446 and §1.1446–4 on distributions of effectively connected income. This paragraph (c)(1)(ii)(A)(*8*) shall apply to partnership taxable years beginning after May 18, 2005, or such earlier time as the regulations under §§1.1446–1 through 1.1446–5 apply by reason of an election under §1.1446–7.

* * * * *

(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) (addressing publicly traded partnerships required to pay withholding tax under section 1446 on distributions of effectively connected income). The reference in the previous sentence to withholding under §1.1446–4 shall apply to partnership taxable years beginning after May 18, 2005, or such earlier time as the regulations under §§1.1446–1 through 1.1446–5 apply by reason of an election under §1.1446–7. * * *

* * * * *

(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) (as applied to publicly traded partnerships required to pay tax under section 1446 on distributions of effectively connected income) 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 May 18, 2005, or such earlier time as the regulations under §§1.1446–1 through 1.1446–5 apply by reason of an election under §1.1446–7. * * *

* * * * *

(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 May 18, 2005, or such earlier time as the regulations under §§1.1446–1 through 1.1446–5 apply by reason of an election under §1.1446–7. * * *

* * * * *

(b) *Withholding of additional tax when underwithholding occurs*. A withholding agent may withhold from future payments (or distributions of effectively connected income under section 1446) made to a beneficial owner the tax that should have been withheld from previous payments (or distributions subject to section 1446) 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 Form 1042 is required to be filed (not including extensions) for the calendar 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 1.1446–7 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 May 18, 2005, or such earlier time as the regulations under §§1.1446–1 through 1.1446–5 apply by reason of an election under §1.1446–7.

* * * * *

(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 1.1446–7. For interest, penalties, and additions to the tax for failure to timely pay the tax required to be paid under section 1446, see sections 6601, 6651, 6655 (in the case of publicly traded partnerships, see section 6656), 6672, and 7202 and the regulations under those sections. For additional penalties and additions to the tax for failure to comply 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 May 18, 2005, or such earlier time as the regulations under §§1.1446–1 through 1.1446–5 apply by reason of an election under §1.1446–7.

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 are 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 by a foreign trust or estate. Further, if a partnership withholds an amount under chapter 3 of the Internal Revenue Code with respect to the allocable share of a partner that is a partnership (upper-tier partnership) or with respect to the allocable 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 May 18, 2005, or such earlier time as the regulations under §§1.1446–1 through 1.1446–5 apply by reason of an election under §1.1446–7.

(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(e) and (f) for application of the rule of this paragraph (a), and for additional rules, where the withholding tax was required to be paid under section 1446. The previous sentence shall apply to partnership taxable years beginning after May 18, 2005, or such earlier time as the regulations under §§1.1446–1 through 1.1446–5 apply by reason of an election under §1.1446–7.

(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. Section 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 or whose taxpayer identification number is required to be furnished on any return, statement, or other document as required by the income tax regulations under section 1446. This paragraph (b)(2)(viii) shall apply to partnership taxable years beginning after May 18, 2005, or such earlier time as the regulations under §§1.1446–1 through 1.1446–5 of this chapter apply by reason of an election under §1.1446–7 of this chapter.

(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 May 18, 2005, or such earlier time as the regulations under §§1.1446–1 through 1.1446–5 of this

chapter apply by reason of an election under §1.1446–7 of this chapter.

* * * * *

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 May 18, 2005, or such earlier time as the regulations under §§1.1446–1 through 1.1446–5 of this chapter apply by reason of an election under §1.1446–7 of this chapter.

PART 602—OMB CONTROL NUMBERS UNDER PAPERWORK REDUCTION ACT

Par. 13. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 14. In §602.101, paragraph (b) is amended by adding entries in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1446–1	1545–1852
1.1446–3	1545–1852
1.1446–4	1545–1852
1.1446–5	1545–1852
1.1446–6T	1545–1934
* * * * *	

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

Approved May 3, 2005.

Eric Solomon,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 13, 2005, 8:45 a.m., and published in the issue of the Federal Register for May 18, 2005, 70 F.R. 28701)

Section 6050L.—Returns Relating to Certain Donated Property

26 CFR 1.6050L–2T: Information returns by donees relating to qualified intellectual property contributions (temporary).

How does a donor notify a donee organization that the donor intends to treat a contribution as a qualified intellectual property contribution, which in turn requires the donee to make a return under section 6050L(b)? See Notice 2005-41, page 1203.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2005. See Rev. Rul. 2005-32, page 1156.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2005. See Rev. Rul. 2005-32, page 1156.

Part III. Administrative, Procedural, and Miscellaneous

Guidance Regarding Qualified Intellectual Property Contributions

Notice 2005–41

PURPOSE

This notice provides guidance regarding § 882 of the American Jobs Creation Act of 2004, Pub. L. No. 108–357, 118 Stat. 1418 (2004), which adds §§ 170(e)(1)(B)(iii) and 170(m) to the Internal Revenue Code and amends § 6050L. Section 170(e)(1)(B)(iii) provides that the amount of a donor's initial charitable contribution deduction allowed under § 170 for contributions of qualified intellectual property is limited to the lesser of the fair market value of, or the donor's adjusted basis in, the qualified intellectual property. Section 170(m) allows the donor to deduct, as a charitable contribution, certain additional amounts based on a percentage of the qualified donee income received by or accrued to the donee with respect to the qualified intellectual property. To qualify for the additional deductions, the donor must notify the donee at the time of the contribution of the donor's intention to take the additional deductions. As amended, § 6050L(b) requires a donee to make a return in the form and manner prescribed by the Secretary with respect to each qualified intellectual property contribution. Sections 170(e)(1)(B)(iii) and 170(m), and the amendments to § 6050L, are effective for contributions made after June 3, 2004.

BACKGROUND

Section 170(a) allows a deduction for a charitable contribution. Generally, if a donor makes a charitable contribution of property, the amount of the deduction is the fair market value of the property at the time of the contribution, reduced as provided in § 170(e) and § 1.170A–4 of the Income Tax Regulations. For certain types of property, § 170(e)(1)(B) reduces the amount of the deduction by the amount of gain that would have been long-term capital gain if the donor had sold the property at its fair market value, determined as of the time of the contribution. Under § 170(e)(1)(B)(iii), this reduction applies in determining a donor's initial deduction for a charitable contribution of "any patent, copyright (other than a copyright described in section 1221(a)(3) or 1231(b)(1)(C)), trademark, trade name, trade secret, know-how, software (other than software described in section 197(e)(3)(A)(i)), or similar property, or applications or registrations of such property."

Subject to the terms and limitations of § 170, § 170(m) allows a donor of qualified intellectual property to deduct, in the year of contribution or in subsequent taxable years, additional amounts based on a percentage (specified in § 170(m)(7)) of the qualified donee income received by or accrued to the donee with respect to the qualified intellectual property. For this purpose, "qualified intellectual property" is property described in § 170(e)(1)(B)(iii) other than property contributed to or for the use of private foundations as defined in § 509(a) (with certain exceptions as described in § 170(b)(1)(E)). "Qualified donee income" is any net income properly allocable to the qualified intellectual property (as opposed to the activity in which the intellectual property is used) that is received by or accrued to the donee organization during the year. Qualified donee income does not include any income received by or accrued to the donee organization after the earlier of the tenth anniversary of the date of the contribution or the expiration of the legal life of the qualified intellectual property. *See* § 170(m)(5) and (6). Additional deductions are allowed, however, only to the extent that the aggregate of the specified percentages of qualified donee income exceeds the initial deduction claimed by the donor. *See* § 170(m)(2).

To qualify for the additional deductions, the donor must inform the donee at the time of the contribution that the donor intends to treat the contribution as a qualified intellectual property contribution (the notification requirement). *See* § 170(m)(8).

Section 6050L(b), as amended by the Act, requires a donee (which may not be a private foundation described in section 170(e)(1)(B)(ii)) that receives notification from the donor to make a return with respect to a qualified intellectual property contribution for each taxable year of the donee showing the amount of any qualified donee income. Section 6050L(c) requires the donee to provide a copy of the return to the donor. *See also* § 1.6050L–2T of the Procedure and Administration Regulations (May 23, 2005); Prop. Treas. Reg. § 1.6050L–2 (May 23, 2005). The amount of net income taken into account by the donor may not exceed the amount of qualified donee income reported by the donee under § 6050L.

GUIDANCE ON THE NOTIFICATION REQUIREMENT

General rule

A donor will satisfy the notification requirement under § 170(m)(8) if the donor delivers or mails to the donee, at the time of the contribution, a written statement containing the following information:

1. The name, address, and taxpayer identification number of the donor;
2. A description of the qualified intellectual property in sufficient detail to identify the qualified intellectual property received by the donee;
3. The date of the contribution to the donee; and
4. A statement that the donor intends to treat the contribution as a qualified intellectual property contribution for purposes of §§ 170(m) and 6050L.

Transitional rule for contributions made after June 3, 2004, and on or before June 20, 2005

Section 170(m) was enacted on October 22, 2004, and is effective for contributions made after June 3, 2004. Donors may have made contributions of qualified intellectual property after June 3, 2004, and may not have informed the donee at the time of the contribution that they intended to treat the contribution as a qualified intellectual property contribution.

A donor who contributed qualified intellectual property after June 3, 2004, and on or before June 20, 2005, without notifying the donee that it intended to treat

the contribution as a qualified intellectual property contribution will be regarded as satisfying the notification requirement if, on or before July 20, 2005, the donor delivers or mails to the donee a written statement containing the information described above.

PAPERWORK REDUCTION ACT

The collection of information in this notice has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1937.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this notice is in the GUIDANCE ON THE NOTIFICATION REQUIREMENT section of this notice. The collection of information is required from donors to satisfy the notification requirement of § 170(m). The collection of information is required from donors to obtain a benefit. The likely respondents are individuals, partnerships, and corporations.

The estimated total annual reporting burden is 30 hours.

The estimated annual burden per respondent varies from 0.5 hours to 1.5 hours, depending on individual circumstances, with an estimated average of 1 hour. The estimated number of respondents is 30.

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 return information are confidential, as required by § 6103.

DRAFTING INFORMATION

The principal authors of this notice are Charles V. Dumas and Susan J. Kassell of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Ms. Kassell at 202–622–5020 (not a toll-free call).

Modification of Application of Rule Prohibiting Deferred Compensation Under a Cafeteria Plan

Notice 2005–42

PURPOSE

The purpose of this notice is to modify the application of the rule prohibiting deferred compensation under a § 125 cafeteria plan. This notice permits a grace period immediately following the end of each plan year during which unused benefits or contributions remaining at the end of the plan year may be paid or reimbursed to plan participants for qualified benefit expenses incurred during the grace period.

BACKGROUND

In general, no amount is included in the gross income of a participant in a cafeteria plan solely because, under the plan, the participant may choose among the benefits of the plan. Section 125(a). A cafeteria plan is defined in § 125(d)(1) as a written plan maintained by an employer under which all participants are employees, and the participants may choose among two or more benefits consisting of cash and qualified benefits. Section 125(f) defines a "qualified benefit" as any benefit which, with the application of § 125(a), is not includable in the gross income of the employee by reason of an express provision of Chapter I of the Internal Revenue Code (other than §§ 106(b), 117, 127 or 132). Qualified benefits include employer-provided accident and health plans excludable from gross income under §§ 106 and 105(b), group-term life insurance excludable under § 79, dependent care assistance programs excludable under § 129 and adoption assistance programs excludable under § 137. Elections under a cafeteria plan, once made, can be changed or revoked only as provided in Treas. Reg. § 1.125–4. A cafeteria plan must have a plan year specified in the written plan document. Prop. Treas. Reg. § 1.125–1, Q&A–3.

Section 125(d)(2)(A) states that the term "cafeteria plan" does not include any plan which provides for deferred compensation. The statutory prohibition on deferred compensation in a cafeteria plan is addressed in Prop. Treas. Reg. §§ 1.125–1 and 1.125–2. Prop. Treas. Reg. § 1.125–2, Q&A–5 states that:

> A cafeteria plan may not include any plan that offers a benefit that defers the receipt of compensation. In addition, a cafeteria plan may not operate in a manner that enables employees to defer compensation. For example, a plan that permits employees to carry over unused elective contributions or plan benefits (*e.g.*, accident or health plan coverage) from one plan year to another operates to defer compensation. This is the case regardless of how the contributions or benefits are used by the employee in the subsequent plan year (*e.g.*, whether they are automatically or electively converted into another taxable or nontaxable benefit in the subsequent plan year or used to provide additional benefits of the same type). Similarly, a cafeteria plan operates to permit the deferral of compensation if the plan permits participants to use contributions for one plan year to purchase a benefit that will be provided in a subsequent plan year … .

See also Prop. Treas. Reg. § 1.125–1, Q&A–7.

Thus, a cafeteria plan does not include any plan that defers the receipt of compensation or operates in a manner that enables participants to defer compensation by, for example, permitting participants to use contributions for one plan year to purchase a benefit that will be provided in a subsequent plan year. This rule is commonly referred to as the "use-it-or-lose-it" rule, requiring that unused contributions or benefits remaining at the end of the plan year be "forfeited."

However, other areas of tax law provide that for a short, limited period, compensation for services paid in the year following the year in which the services that are being compensated were performed is not treated as "deferred compensation." For example, Treas. Reg. § 1.404(b)–1T, Q&A–2(a) provides that for purposes of the deduction rules in § 404(a), (b) and (d), a plan, or method or arrangement defers the receipt of compensation or benefits to the extent it is one under which an employee receives compensation or benefits more than a brief period of time after the end of the employer's taxable year in which the services cre-

ating the right to such compensation or benefits are performed. Under Treas. Reg. § 1.404(b)–1T, Q&A–2(c), a plan, or method or arrangement shall not be considered as deferring the receipt of compensation or benefits for more than a brief period of time after the end of the employer's taxable year to the extent that compensation or benefits are received by the employee on or before the fifteenth day of the third calendar month after the end of the employer's taxable year in which the services are rendered. *See also Weaver v. Commissioner*, 121 T.C. 273 (2003); Rev. Rul. 88–68, 1988–2 C.B. 117. *Cf.* H. R. Conf. Rep. No. 755, 108th Cong., 2d Sess. at 735 (2004) (§ 409A "does not apply to annual bonuses or other annual compensation amounts paid within 2 and 1/2 months after the close of the taxable year in which the relevant services required for payment have been performed"). Consistent with these other areas of tax law, Treasury and the IRS believe it is appropriate to modify the current prohibition on deferred compensation in the proposed regulations under § 125 to permit a grace period after the end of the plan year during which unused benefits or contributions may be used.

MODIFICATION OF APPLICATION OF RULE PROHIBITING DEFERRED COMPENSATION UNDER A § 125 CAFETERIA PLAN

The rule that a cafeteria plan may not defer the receipt of compensation as set out in Prop. Treas. Reg. §§ 1.125–1 and 1.125–2 is modified as follows: A cafeteria plan document may, at the employer's option, be amended to provide for a grace period immediately following the end of each plan year. The grace period must apply to all participants in the cafeteria plan. Expenses for qualified benefits incurred during the grace period may be paid or reimbursed from benefits or contributions remaining unused at the end of the immediately preceding plan year. The grace period must not extend beyond the fifteenth day of the third calendar month after the end of the immediately preceding plan year to which it relates (*i.e.*, "the 2 and 1/2 month rule"). If a cafeteria plan document is amended to include a grace period, a participant who has unused benefits or contributions relating to a particular qualified benefit from the immediately preceding plan year, and who incurs expenses for that same qualified benefit during the grace period, may be paid or reimbursed for those expenses from the unused benefits or contributions as if the expenses had been incurred in the immediately preceding plan year. The effect of the grace period is that the participant may have as long as 14 months and 15 days (the 12 months in the current cafeteria plan year plus the grace period) to use the benefits or contributions for a plan year before those amounts are "forfeited" under the "use-it-or-lose-it" rule.

During the grace period, a cafeteria plan may not permit unused benefits or contributions to be cashed-out or converted to any other taxable or nontaxable benefit. Unused benefits or contributions relating to a particular qualified benefit may only be used to pay or reimburse expenses incurred with respect to that particular qualified benefit. For example, unused amounts elected to pay or reimburse medical expenses in a health flexible spending arrangement (FSA) may not be used to pay or reimburse dependent care or other expenses incurred during the grace period. To the extent any unused benefits or contributions from the immediately preceding plan year exceed the expenses for the qualified benefit incurred during the grace period, those remaining unused benefits or contributions may not be carried forward to any subsequent period (including any subsequent plan year) and are "forfeited" under the "use-it-or-lose-it" rule. As under current practice, employers may continue to provide a "run-out" period after the end of the grace period, during which expenses for qualified benefits incurred during the cafeteria plan year and the grace period may be paid or reimbursed.

An employer may adopt a grace period as authorized in this notice for the current cafeteria plan year (and subsequent cafeteria plan years) by amending the cafeteria plan document before the end of the current plan year.

The rules of this notice are illustrated by the following examples:

Example (1). Employer with a cafeteria plan year ending on December 31, 2005, amended the plan document before the end of the plan year to permit a grace period which allows all participants to apply unused benefits or contributions remaining at the end of the plan year to qualified benefits incurred during the grace period immediately following that plan year. The grace period adopted by the employer ends on the fifteenth day of the third calendar month after the end of the plan year (March 15, 2006, for the plan year ending December 31, 2005). Employee X timely elected salary reduction of $1,000 for a health FSA for the plan year ending December 31, 2005. As of December 31, 2005, X has $200 remaining unused in his health FSA. X timely elected salary reduction for a health FSA of $1,500 for the plan year ending December 31, 2006. During the grace period from January 1 through March 15, 2006, X incurs $300 of unreimbursed medical expenses (as defined in § 213(d)). The unused $200 from the plan year ending December 31, 2005, is applied to pay or reimburse $200 of X's $300 of medical expenses incurred during the grace period. Therefore, as of March 16, 2006, X has no unused benefits or contributions remaining for the plan year ending December 31, 2005. The remaining $100 of medical expenses incurred between January 1 and March 15, 2006, is paid or reimbursed from X's health FSA for the plan year ending December 31, 2006. As of March 16, 2006, X has $1,400 remaining in the health FSA for the plan year ending December 31, 2006.

Example (2). Same facts as Example (1), except that X incurs $150 of § 213(d) medical expenses during the grace period (January 1 through March 15, 2006). As of March 16, 2006, X has $50 of unused benefits or contributions remaining for the plan year ending December 31, 2005. The unused $50 cannot be cashed-out, converted to any other taxable or nontaxable benefit, or used in any other plan year (including the plan year ending December 31, 2006). The unused $50 is subject to the "use-it-or-lose-it" rule and is "forfeited." As of March 16, 2006, X has the entire $1,500 elected in the health FSA for the plan year ending December 31, 2006.

EFFECT ON OTHER DOCUMENTS

Future guidance will modify Prop. Treas. Reg. §§ 1.125–1 and 1.125–2 to reflect the provisions in this notice.

DRAFTING INFORMATION

The principal author of this notice is Elizabeth Purcell of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, contact Ms. Purcell at (202) 622–6080 (not a toll-free call).

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, Section 7605; 301.7605–1.)

Rev. Proc. 2005–32

SECTION 1. PURPOSE

The purpose of this revenue procedure is to amplify, update, and restate Rev. Proc. 94–68, 1994–2 C.B. 803, which provides Internal Revenue Service procedures with respect to the reopening of examinations under section 7605(b) of the Internal Revenue Code. This revenue procedure also describes when a case is deemed closed after examination by the Service, describes, by category, a non-exclusive list of contacts with taxpayers and other actions by the Service that are not examinations, inspections, or reopenings of closed cases, explains when a closed case may be reopened to make an adjustment unfavorable to the taxpayer, and explains who within the Service must approve a reopening.

SECTION 2. SIGNIFICANT CHANGES

.01 Examples in Rev. Proc. 94–68 of contacts by the Service with taxpayers or other actions taken with respect to taxpayers that are not examinations, inspections, or reopenings have been categorized under four non-exclusive categories.

.02 A new section 4.01(4) is added to define a closed case when dealing with classification or qualification cases subject to section 7428.

.03 A new section 4.01(5) is added to define a closed case when dealing with Tax Equity and Fiscal Responsibility Act (TEFRA) partnership cases.

.04 A new section 4.02 is added to define a reopening of a closed case.

.05 Section 4.02, *Examinations, Inspections, and Reopenings*, of Rev. Proc. 94–68 has been redesignated and renamed as section 4.03, *Taxpayer contacts and other actions that are not examinations, inspections, or reopenings*.

.06 Section 4.03(1)(d)(ii)(B) includes new items that provide that a contact with a taxpayer to request the taxpayer file a required tax return, to explain the criteria for perfecting a filed but imperfect tax return, or to request the taxpayer perfect a filed tax return, is not an examination, inspection, or reopening.

.07 Section 4.03(2)(d) adds the Industry Issue Resolution program as a new item to the examples of voluntary programs for selective issue resolution that are not examinations, inspections, or reopenings.

.08 Section 4.03(4) includes a new example providing that a contact with a taxpayer for the purpose of investigating a possible violation of title 31 of the United States Code is not an examination, inspection, or reopening for any purpose under title 26.

.09 New section 4.03(4)(b) is added to provide that a contact with any person for the purpose of determining whether that person is required to maintain a list under section 6112, or to inspect the list required to be maintained under section 6112, or to verify the accuracy of, or the need for, disclosure of a reportable transaction as required by section 6111 (or registration of a tax shelter as required by former section 6111) is not an examination, inspection, or reopening with respect to any other party.

.10 New section 5.02 provides that an examination of a tax return following a prior examination of the same taxpayer for the same taxable period that was limited to one or more transactions with significant potential for abuse satisfies the criteria for reopening of a case closed after examination.

SECTION 3. SCOPE

This revenue procedure applies to all examinations, inspections of books of account, and reopenings of cases closed after examination, regardless of taxpayer or type of tax, but does not extend to cases beyond the jurisdiction of the highest level field official with ultimate authority over the case, presently the Area Director for Compliance or the Industry Director. It does not apply to cases closed after consideration by Appeals or any functional component of the Office of Chief Counsel.

The categories and examples in section 4.03 below of contacts with taxpayers and other actions taken by the Service with respect to taxpayers that are not examinations, inspections, or reopenings are not intended to be, and should not be construed as, exhaustive, exclusive, or limitative. Thus, a contact with, or other action in relation to, a taxpayer may be other than an examination, inspection, or reopening even though it may not be listed as an example or may be outside of a category described in this revenue procedure.

SECTION 4. DEFINITIONS

.01 *Closed case*.

(1) For purposes of this revenue procedure, an agreed case is closed after examination when the Service notifies the taxpayer in writing after a conference, if any, of adjustments to the taxpayer's liability or acceptance of the taxpayer's tax return or exempt status without change. A case involving a refund or credit in excess of the statutory sum that is subject to review by the Joint Committee on Taxation, pursuant to section 6405, is not a closed case until Joint Committee review procedures and any necessary follow-up are complete. Also, in a fully agreed case in which the taxpayer and the Service have entered into a closing agreement, as described in section 7121, following examination, the case is not a closed case until the closing agreement is signed by an appropriate Service official.

(2) An unagreed income, estate, gift, or chapters 41 through 44 excise tax case, or a worker classification or plan qualification case subject to section 7436 or section 7476, is closed after examination when the period for filing a petition with the United States Tax Court, as specified in the statutory notice of deficiency or notice of determination issued to the taxpayer, expires with no petition filed.

(3) An unagreed excise tax case not subject to the deficiency procedures of sections 6211 through 6215 or an employment tax case not subject to the determination of employment status procedures of section 7436 is closed after examination when the period specified in the preliminary letter for requesting a hearing with Appeals expires and no request has been made.

(4) An unagreed classification or qualification case subject to section 7428 is closed after examination when the period expires for bringing an action in the United States Tax Court, the United States Court of Federal Claims, or the United States District Court for the District of Columbia, and no action has been filed.

(5) An unagreed TEFRA partnership case is closed when the period for bringing an action in the United States Tax Court, a

district court, or the United States Court of Federal Claims with respect to a Notice of Final Partnership Administrative Adjustment (FPAA) expires and no action has been filed. A TEFRA partnership case is an agreed case and is closed as an agreed case only if all partners have signed settlement agreements or a no-change letter has been issued to the Tax Matters Partner. A no-change FPAA alone does not signify an agreed case.

.02 *Reopening*. A reopening of a closed case involves an examination of a taxpayer's liability that may result in an adjustment to liability unfavorable to the taxpayer for the same taxable period as the closed case, with exceptions, some of which are noted below. The Service's review, including an inspection of books of account, of a taxpayer's claim for a refund on an amended excise or income tax return, as well as the Service's review of a Form 843, *Claim for Refund and Request for Abatement*, claiming a refund for an overpayment reported on a return, is not a reopening.

.03 *Taxpayer contacts and other actions that are not examinations, inspections, or reopenings*. In addition to the exception provided in § 301.7605–1(h) of the Procedural and Administrative Regulations, listed below are four categories of contacts the Service makes with taxpayers and certain other actions taken by the Service that are not examinations, inspections, or reopenings.

(1) In the first category are narrow, limited contacts or communications between the Service and a taxpayer that do not involve the Service inspecting the taxpayer's books of account:

(a) looking at a tax return;

(b) matching information on a tax return with, or preparing a missing return from, other records or information items that are already in the Service's possession; or

(c) considering any records the taxpayer voluntarily provides to the Service to explain an apparent error on a tax return or to explain a discrepancy between either a filed tax return or a substitute for return and information from third parties that is or may be used for the matching described in (b).

(d) The following examples, illustrative of this category 4.03(1), are not examinations, inspections, or reopenings:

(i) a contact with a Coordinated Industry Case (CIC) taxpayer requesting the written statements provided for in Rev. Proc. 94–69, 1994–2 C.B. 804 (or successor revenue procedure), or notifying a taxpayer that the taxpayer no longer qualifies for the CIC program;

(ii) a contact with a taxpayer to:

(A) correct mathematical or clerical errors;

(B) request the taxpayer file a tax return, or if a tax return is incomplete, to explain the criteria for perfecting the tax return, or to solicit the taxpayer's perfection of the tax return; or

(C) verify a discrepancy between the taxpayer's tax return and an information return, or between a tax return and information otherwise in the Service's possession; and

(iii) adjustments resulting from:

(A) an unallowable item;

(B) a discrepancy between a filed tax return and information received from a third party or a federal or state governmental databank; or

(C) an information-return matching program, or other correction programs operated by Internal Revenue Service Centers or Campuses.

(2) In the second category are Service-administered programs for selective issue resolution that are open to the voluntary participation of taxpayers, and which invite the Service's involvement with respect to one or more taxable periods earlier than otherwise under the Service's normal audit procedures. The following are examples of these Service-administered programs:

(a) accelerated issue resolution;

(b) the Advance Pricing Agreement program;

(c) the Pre-Filing Agreement program; and

(d) the Industry Issue Resolution program.

(3) The third category consists of reconsiderations (and resulting adjustments to liability) of a taxable period previously examined or adjusted when those reconsiderations arise from and are affected by the treatment of, or a position taken with respect to, tax return items or transactions by the same taxpayer in a different (usually later) taxable period, or by a related taxpayer in any taxable period. Cases in this category 4.03(3) are not reopenings. Examples include adjustments for:

(a) a correction under section 1311;

(b) a change to an item carried back that affects liability for the carryback year; and

(c) a gain under section 1033 on the involuntary conversion of property.

(4) A fourth category consists of contacts, compliance checks, examinations, or investigations of a taxpayer or a third party for one purpose, tax, or period (even if a dual purpose is present at the outset) that result in the Service obtaining information relevant or useful for a different purpose, tax, or period that may later either be matched with a return under the circumstances described in section 4.03(1) or may lead the Service to later open an examination or inspection for that different purpose, tax, or period. For example, a contact with a taxpayer, including an inspection of the taxpayer's books of account, for the purpose of investigating a possible violation of title 31 is not an examination, inspection, or reopening for any purpose under title 26. Other examples include:

(a) a contact by a Tax Exempt and Government Entities (TE/GE) agent with the employer sponsor of a deferred compensation plan, or with an organization treating itself as tax-exempt, to investigate the plan's compliance with Code requirements or the organization's exempt status under the Code. This contact, and any follow-up information matching, is not an income tax examination, inspection, or reopening with respect to the employer, its employees, any plan beneficiaries, or any other third parties that may have a transactional relationship to the exempt organization (such as the organization's employees, independent contractors, taxable subsidiaries, or sellers of property to the exempt organization); and

(b) a contact with or action taken with respect to any person for the purpose of determining whether that person is required to maintain a list under section 6112(a), or to inspect the list required to be maintained under section 6112(a), or to verify the accuracy of, or the need for, disclosure of a reportable transaction as required by section 6111 (or registration of a tax shelter as required by former section 6111). This contact or other action is not an examination, inspection, or reopening with respect to any other party.

SECTION 5. REOPENING CLOSED CASES

.01 *General circumstances permitting reopening*. The Service will not reopen a case closed after examination to make an adjustment to liability unfavorable to the taxpayer unless:

(1) there is evidence of fraud, malfeasance, collusion, concealment, or misrepresentation of material fact;

(2) the closed case involved a clearly-defined, substantial error based on an established Service position existing at the time of the examination; or

(3) other circumstances exist indicating that a failure to reopen the case would be a serious administrative omission.

.02 *Other circumstances permitting reopening*. Under section 5.01(3) of this revenue procedure, other circumstances indicating that a failure to reopen a case would be a serious administrative omission include cases with items or transactions that present significant potential for abuse for which a limited examination was performed. If the Service conducted and closed an examination that was limited to one or more tax return items or transactions with significant potential for abuse, and the Service later determines that other tax return items or transactions for the same taxpayer and the same taxable period also merit examination, the examination may be reopened. Items or transactions with significant potential for abuse may include reportable transactions within the meaning of § 1.6011–4(b). In these circumstances, a subsequent examination by the Service of other tax return items for the same taxpayer and the same taxable year is not an unnecessary examination under section 7605(b) and the failure to reopen such cases would be a serious administrative omission.

.03 *Approval*. All reopenings must be approved by, and all notices of an additional inspection of a taxpayer's books of account must be signed by, an official listed in Commissioner Delegation Order Number 57 (or successor order) for cases under his or her jurisdiction.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 94–68 is modified and superseded.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective on May 20, 2005.

DRAFTING INFORMATION

The principal author of this revenue procedure is Stuart Murray of the Office of the Associate Chief Counsel (Procedure & Administration). For further information regarding this revenue procedure, contact Stuart Murray at (202) 622–3630 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking, Notice of Proposed Rulemaking by Cross Reference to Temporary Regulations and Notice of Public Hearing

Section 1446 Regulations; Withholding on Effectively Connected Taxable Income Allocable to Foreign Partners

REG–108524–00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking, notice of proposed rulemaking by cross reference to temporary regulations and notice of public hearing.

SUMMARY: The IRS is proposing to issue temporary regulations under section 1446 of the Internal Revenue Code relating to the circumstances under which a partnership may take partner-level deductions and losses into account in computing its withholding tax obligation with respect to a foreign partner's allocable share of effectively connected taxable income. The text of the temporary regulations (T.D. 9200) published elsewhere in this issue of the Bulletin also serves as the text of these proposed regulations. In addition, the proposed regulations amend regulations under sections 1464, 6071, 6091, 6151, 6302, 6402, 6414, and 6722 to implement the section 1446 regime. This document also provides a notice of public hearing on these proposed regulations.

DATES: Written or electronic comments and requests to comment at the public hearing scheduled for October 3, 2005, must be received by August 16, 2005.

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 20044. Alternatively, taxpayers may submit comments electronically via either the IRS internet site at *www.irs.gov/regs* or the Federal eRulemaking Portal at *www.regulations.gov* (IRS and REG–108524–00). The public hearing will be held in the Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC on October 3, 2005.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Ronald M. Gootzeit, at (202) 622–3860 or to be placed on the attendance list for the hearing, Richard A. Hurst 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, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collections of information should be received by July 18, 2005. 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 §1.1446–6T. This information is required to determine the extent to which a partnership is required to pay a withholding tax under section 1446 with respect to its effectively connected taxable income allocable to a foreign partner. The reporting requirement in §1.1446–6T is voluntary. The likely respondents include individuals, businesses or other for profit institutions, and small businesses or organizations.

Estimated total annual reporting burden: 2,500 hours.

Estimated average annual burden hours per respondent: .5 hours.

Estimated number of respondents: 5,000.

Estimated annual frequency of responses: on occasion and annually.

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

Temporary regulations published elsewhere in this issue of the Bulletin amend the Income Tax Regulations (26 CFR part 1) relating to section 1446. The text of those regulations also serves as the text of the proposed regulations pertaining to section 1446 that are included in this document. The preamble to the temporary regulations explains the amendments to section 1446. The proposed regulations also amend the Income Tax and Procedure and Administration Regulations (26 CFR Parts 1 and 301) relating to sections 1464, 6071,

6091, 6151, 6302, 6402, 6414, and 6722. The amendments to these sections are necessary to coordinate the sections with the final section 1446 regulations issued elsewhere in this issue of the Bulletin.

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. It is hereby certified that the collections of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that only a limited number of small entities are impacted by these collections and the burden associated with such collections is .5 hours. Moreover, the information collection in §1.1446–6T 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. 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. All comments will be available for public inspection and copying.

A public hearing has been scheduled for October 3, 2005, beginning at 10 a.m. in the Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. All visitors must enter at 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 August 16, 2005. 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 authors of these proposed regulations are David J. Sotos, formerly of the Office of the Associate Chief Counsel (International), and Ronald M. Gootzeit of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and IRS participated in their development.

* * * * *

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 * * *

§1.1446–6 also issued under 26 U.S.C. 1446(f).* * *

Par. 2. Section 1.1446–6 is added to read as follows:

§1.1446–6 Special rules to reduce a partnership's 1446 tax with respect to a foreign partner's allocable share of effectively connected taxable income.

[The text of this proposed section is the same as the text of §1.1446–6T published elsewhere in this issue of the Bulletin].

Par. 3. In §1.1464–1, paragraph (a) is amended by adding three sentences at the end of the paragraph to read as follows:

§1.1464–1 Refunds or credits.

(a) * * * With respect to section 1446, this section shall only apply to a publicly traded partnership described in §1.l446–4. See §1.1446–3(d)(2)(iv) for rules permitting a withholding agent to obtain a refund of tax paid under section 1446. The previous two sentences shall apply to partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

* * * * *

Par. 4. In §1.6071–1, paragraph (c)(15) is revised to read as follows:

§1.6071–1 Time for filing returns and other documents.

* * * * *

(c) * * *

(15) For provisions relating to the time for filing an annual information return on Form 1042–S or Form 8805 of the tax withheld under chapter 3 of the Internal Revenue Code (relating to withholding of tax on nonresident aliens and foreign corporations and tax-free covenant bonds), see §1.1461–1(c) and §1.1446–3(d). The references in the previous sentence to Form 8805 and §1.1446–3(d) shall apply to partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

* * * * *

Par. 5. In §1.6091–1, paragraph (b)(17) is added to read as follows:

§1.6091–1 Place for filing returns or other documents.

* * * * *

(b) * * *

(17) For the place for filing information returns on Form 8805 with respect to certain amounts paid on behalf of foreign partners, see the instructions to the form.

* * * * *

Par. 6. In §1.6151–1, paragraph (d)(2) is revised to read as follows:

§1.6151–1 Time and place for paying tax shown on returns.

* * * * *

(d) * * *

(2) For provisions relating to the use of such financial institutions for the deposit of taxes required to be withheld under chapter 3 of the Internal Revenue Code on nonresident aliens and foreign corporations and tax-free covenant bonds, see §1.6302–2. With respect to section 1446, the previous sentence shall apply only to a publicly traded partnership described in §1.1446–4. This paragraph shall apply to publicly traded partnerships described in the previous sentence only for partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

* * * * *

Par. 7. In §1.6302–2, paragraphs (a)(1)(i) and (2) are revised to read as follows:

§1.6302–2 Use of Government depositaries for payment of tax withheld on nonresident aliens and foreign corporations.

(a) * * *

(1) * * *

(i) *Monthly deposits*. Except as provided in paragraphs (a)(1)(ii) and (iv) of this section, every withholding agent who, pursuant to chapter 3 of the Internal Revenue Code, has accumulated at the close of any calendar month beginning on or after January 1, 1973, an aggregate amount of undeposited taxes of $200 or more shall deposit such aggregate amount with an authorized financial institution (see paragraph (b)(1)(ii) of this section) within 15 days after the close of such calendar month. However, the preceding sentence shall not apply if the withholding agent has made a deposit of taxes pursuant to paragraph (a)(1)(ii) of this section with respect to a quarter monthly period which occurred during such month. With respect to section 1446, this section shall only apply to a publicly traded partnership described in §1.1446–4. The previous sentence shall apply to partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

* * * * *

(2) *Cross reference*. For rules relating to the adjustment of deposits, see §1.1461–2(b) and §1.6414–1. For rules requiring payment of any undeposited tax, see §1.1461–1.

* * * * *

Par. 8. Section 1.6414–1 is amended by:

1. Adding three sentences at the end of the undesignated text following paragraph (a)(2).

2. Revising the third sentence of paragraph (b).

The addition and revision read as follows:

§1.6414–1 Credit or refund of tax withheld on nonresident aliens and foreign corporations.

(a) * * * With respect to the payment of withholding tax under section 1446, this section shall only apply to a publicly traded partnership described in §1.1446–4. See §1.1446–3(d)(2)(iv) for rules regarding refunds to a withholding agent under section 1446. The previous two sentences shall apply to partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

(b) * * * The amount so claimed as a credit may be applied, to the extent it has not been applied under paragraph (b) of §1.1461–2, by the withholding agent to reduce the amount of a payment or deposit of tax required by §1.1461–1 or paragraph (a) of §1.6302–2 for any payment period occurring in the calendar year following the calendar year of overwithholding. * * *

* * * * *

PART 301—PROCEDURE AND ADMINISTRATION

Par. 9. The authority for 26 CFR part 301 continues to read, in part, as follows:

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

Par. 10. In §301.6302–1, paragraph (b)(2) is revised to read as follows:

§301.6302–1 Mode or time of collection of taxes.

* * * * *

(b) * * *

(2) For provisions relating to the use of Federal Reserve banks or authorized commercial banks in depositing the tax required to be withheld under chapter 3 of the Internal Revenue Code on nonresident aliens and foreign corporations and tax-free covenant bonds, see §1.6302–2 of this chapter. The previous sentence shall include payment of withholding tax under section 1446 and §1.1446–4. References in this paragraph (b)(2) to payment of withholding tax under section 1446, shall apply to partnership taxable years beginning after the date these regulations are published in the **Federal Register**.

Par. 11. In §301.6402–3, the second and third sentences of paragraph (e) are revised, and a sentence is added at the end of the paragraph to read as follows:

§301.6402–3 Special rules applicable to income tax.

* * * * *

(e) * * * Also, if the overpayment of tax resulted from the withholding of tax at source under chapter 3 of the Internal Revenue Code, a copy of the Form 1042–S, Form 8805, or other statement (see §1.1446–3(d)(2)) required to be provided to the beneficial owner or partner pursuant to §1.1461–1(c)(1)(i) or §1.1446–3(d) of this chapter must be attached to the return. For purposes of claiming a refund, the Form 1042–S, Form 8805, or other statement must include the taxpayer identification number of the beneficial owner or partner even if not otherwise required. * * * References in this paragraph to Form 8805 or other statements required under §1.1446–3(d)(2) shall apply to partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

Par. 12. In §301.6722–1, paragraph (d)(3) is revised to read as follows:

§301.6722–1 Failure to furnish correct payee statements.

* * * * *

(d) * * *

(3) *Other items*. The term *payee statement* also includes any form, statement, or schedule required to be furnished to the recipient of 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 the recipient copy of Form 1042–S or Form 8805. The reference in the previous sentence to Form 8805 shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register**.

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on May 13, 2005, 8:45 a.m., and published in the issue of the Federal Register for May 18, 2005, 70 F.R. 28743)

Guidance Under Section 355(e); Recognition of Gain on Certain Distributions of Stock or Securities in Connection With an Acquisition; Correction

Announcement 2005–41

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to final regulations and removal of temporary regulations.

SUMMARY: This document corrects final regulations and removal of temporary regulations (T.D. 9198, 2005–18 I.R.B. 972), that were published in the **Federal Register** on Tuesday, April 19, 2005 (70 FR 20279) that relate to the recognition of gain on certain distributions of stock or securities of a controlled corporation in connection with an acquisition.

DATES: This correction is effective April 19, 2005.

FOR FURTHER INFORMATION CONTACT: Amber R. Cook, (202) 622–7530 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations and removal of temporary regulations (T.D. 9198), which is the subject of this correction are under section 355(e) of the Internal Revenue Code.

Need for Correction

As published, the final regulations and removal of temporary regulations (T.D. 9198) contain errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the final regulations and removal of temporary regulations (T.D. 9198), which was the subject of FR. Doc. 05–7811, is corrected as follows:

1. On page 20280, column 2, in the preamble, under the paragraph heading "New Safe Harbor for Acquisitions Before a *Pro Rata* Distribution", line 9, the language "discussions regarding the acquisition" is corrected to read "discussions with the acquirer regarding a distribution".

2. On page 20280, column 2, in the preamble, under the paragraph heading "New Safe Harbor for Acquisitions Before a *Pro Rata* Distribution", lines 15 and 16, the language "prior to discussions regarding the acquisition and that the acquisition was" is corrected to read "prior to discussions regarding a distribution and that the acquisition was".

Cynthia E. Grigsby,
Acting Chief, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration).

(Filed by the Office of the Federal Register on May 16, 2005, 8:45 a.m., and published in the issue of the Federal Register for May 17, 2005, 70 F.R. 28211)

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z —Corporation.

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