

## TAX ALERT

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### **Affidavit avoids new withholding requirements on sale of partnership interests: New IRC Sections 864(c)(8) and 1446(f)**



The tax act contains provisions regarding withholding on the sale or redemption of tax partnership interests (including limited liability companies taxed like partnerships) that require immediate attention.

A recent Tax Court case held that a foreign partner's gain on the redemption of a partnership interest was not U.S.-source income and was not effectively connected income (ECI), even though the partnership was engaged in a U.S. trade or business. The decision was in contrast to prior IRS guidance on the issue. In response to the decision, the tax act added new code provisions.

In general, new Code section 864(c)(8) provides that a nonresident alien individual's or foreign corporation's gain or loss from the sale, exchange or other disposition of a partnership interest is effectively connected with the conduct of a trade or business in the United States to the extent that the person would have had effectively connected gain or loss had the partnership sold all of its assets at fair market value. The gain or loss is

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reduced by any amount treated as a U.S. real property interest under Code section No. 897. The new Code section applies to sales, exchanges or other dispositions occurring on or after Nov. 27, 2017.

In general, new Code section 1446(f)(1) provides that if any portion of the gain on any disposition of an interest in a partnership would be treated under new section 864(c)(8) as effectively connected with the conduct of a trade or business within the United States (effectively connected gain), then the purchaser must withhold a tax equal to 10 percent of the amount realized on the disposition. The amount realized presumably includes the purchase price plus any debt relief. If the purchaser does not withhold when required, the partnership is required to withhold from distributions to the purchaser an amount equal to the under-withholding plus interest. It is unclear what the impact of a tax treaty might be with regard to withholding. Under an exception in new Code section 1446(f)(2), however, withholding is generally not required if the seller furnishes an affidavit to the purchaser stating, among other things, that the seller is not a foreign person.



**Practice point: The 10 percent withholding is not required if the seller provides a non-foreign person affidavit.**

Apparently, the withholding provision amount applies even if the tax partnership only has a small amount of ECI. So, for example, if a partner sold his interest for \$700,000 and had \$300,000 of debt relief, the withholding obligation (absent an affidavit and not considering potential treaty issues) would be \$100,000, even if the partnership had only \$50,000 of ECI. The withholding issue might be more complicated if the debt relief were the major component of the purchase price so that there may not be enough proceeds to withhold.

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While future guidance may provide other alternatives, the safest course of action would be to include the affidavit requirement, if factually appropriate, in all partnership and limited liability company interest purchase agreements. Further, tax partnerships and their general partners and limited liability company managers should be made aware of these provisions as it could impact their duties and the tax partnership's responsibilities, including the responsibility to withhold if the buyer fails to withhold when required.

For more information please contact [Dave Tumen](#) or any member of Porter Wright's [Tax Practice Group](#).

