

**DEPARTMENT OF THE TREASURY****Internal Revenue Service****26 CFR Parts 1 and 301****[REG-108524-00]****RIN 1545-AY28****Section 1446 Regulations****AGENCY:** Internal Revenue Service (IRS), Treasury.**ACTION:** Notice of proposed rulemaking.

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

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

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

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

**SUPPLEMENTARY INFORMATION:****Paperwork Reduction Act**

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of

Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collections of information should be received by November 3, 2003. Comments are specifically requested concerning:

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

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

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

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

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

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

*Estimated total annual reporting burden:* 7,805 hours.

*Estimated average annual burden hours per respondent:* 0.5 hours.

*Estimated number of respondents:* 15,775.

*Estimated annual frequency of responses:* on occasion and quarterly.

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

number assigned by the Office of Management and Budget.

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

**Background**

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

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

**Explanation of Provisions****A. In General**

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