

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 As originally enacted, section 1446 generally required both domestic and foreign partnerships with any income, gain, or loss that was effectively connected with the conduct of a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

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

Section 1446, as revised by the 1988 Act, shifted from imposing a withholding tax on partnership distributions to imposing a withholding tax on the amount of ECTI allocable to the partnership's foreign partners. More specifically, section 1446(a) requires partnerships that have ECTI in any taxable year, any portion of which is allocable under section 704 to a foreign partner, to pay the 1446 tax at such time and in such manner as prescribed in regulations. The amount of withholding tax payable by a partnership under section 1446 is equal to the applicable percentage of the partnership's ECTI allocable under section 704 to foreign partners. The applicable percentage for ECTI allocable to a foreign corporation is the highest rate of tax specified in section 11(b), and the applicable percentage for ECTI allocable to a non-corporate foreign partner is the highest rate of tax specified in section 1.

Further, section 1446(d), as amended by the 1988 Act, provides that a foreign partner is entitled to a credit under section 33 for such partner's share of the 1446 tax, and, except as provided in regulations, such partner's share of the 1446 tax paid by the partnership is treated as distributed to such partner on the last day of the taxable year for which such tax was paid. The credit under section 33 is applied against the partner's U.S. tax liability for the taxable year in which the partner includes its

allocable share of the partnership's effectively connected income.

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

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

In 1992, Treasury and the IRS issued Rev. Proc. 92-66, which modified Rev. Proc. 89-31 in three respects. First, Rev. Proc. 92-66 provides that the applicable percentage to be used by publicly traded partnerships in calculating the 1446 tax is the highest rate of tax imposed under section 1, which at that time was 31 percent. Second, the revenue procedure allows a partnership to seek a refund from the IRS in certain circumstances for amounts it has paid under section 1446. Third, the revenue procedure provides that a foreign partnership

subject to withholding under section 1445(a) during a taxable year is allowed to credit the amount withheld under section 1445(a), to the extent such amount is allocable to foreign partners, against its liability to pay the 1446 tax for that year.

B. Structure of the Proposed Regulations

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

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

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

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