

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

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

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

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

Treasury and the IRS are concerned about the potential abuse of tiered trust structures to claim inappropriate refunds of the 1446 tax, to avoid reporting by a beneficiary of ECTI earned by a partnership, or to avoid section 1446 entirely. Existing provisions contemplate that entitlement

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

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

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

The second rule addresses the use of a domestic trust. The second rule applies where a partnership knows or has reason to know that a foreign person

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

G. Publicly Traded Partnerships—§ 1.1446-4

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

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

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