

Rev. Proc. 89-31, the publicly traded partnership makes this election by complying with the payment and reporting requirements of the general rules and attaching a statement to its annual return of withholding tax indicating that the election is being made.

The proposed regulations modify several of the rules for publicly traded partnerships set forth in Rev. Proc. 89-31. First, the proposed regulations define *publicly traded partnership* solely by reference to the definition in section 7704. Second, the proposed regulations provide that the documentation requirements and presumptions of § 1.1446-1 apply to publicly traded partnerships, thereby requiring such partnerships to obtain a Form W-8BEN, Form W-8IMY, or Form W-9 from each of their partners if they do not rely on other means to determine the status of their partners. Third, the proposed regulations provide that the applicable percentage for withholding on distributions is the rate applicable under section 1446(b).

Comments are requested as to whether the special rules applicable to publicly traded partnerships should be extended to other partnerships. Specifically, Treasury and the IRS are considering whether these special rules should apply to partnerships that make an election under section 775 of the Code or partnerships with a specified minimum number of partners.

H. Tiered Partnership Structures—§ 1.1446-5

Special concerns arise when a foreign partnership (upper-tier partnership) is a partner in a second partnership (lower-tier partnership) that is subject to section 1446. Section 1446(f) provides the Secretary with regulatory authority to prescribe rules necessary to carry out the purposes of the section. The legislative history to section 1446 notes that in the context of tiered partnership structures, "rules may be necessary to prevent the imposition of more tax than will be properly due (for example, rules to prevent the tax from being imposed on more than one partnership and rules to determine the applicable percentages)." 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 employs an entity approach in computing the 1446 tax obligation of a partnership that has a foreign partnership as one of its partners. Under the entity approach, a lower-tier partnership must pay a 1446 tax at the highest rate in section 1 on an upper-tier foreign partnership's

allocable share of ECTI, regardless of the composition of the upper-tier partnership. Rev. Proc. 89-31 provides the upper-tier partnership a credit for a portion of the 1446 tax paid by the lower-tier partnership to avoid multiple application of the 1446 tax. This approach may result in a partnership paying a 1446 tax that is greater in amount than would have been required if the partners of the upper-tier partnership had been direct partners of the lower-tier partnership, for example, where some of the partners of the upper-tier partnership are U.S. persons.

The proposed regulations modify the rules in Rev. Proc. 89-31 with respect to certain tiered partnership structures to address this situation. The proposed regulations provide that if a partner in a partnership that is required to pay the 1446 tax is a foreign partnership, it may submit a completed Form W-8IMY to the lower-tier partnership. If the upper-tier foreign partnership completes and submits Form W-8IMY to the lower-tier partnership, and passes along the Form W-8BEN, Form W-8IMY, or Form W-9 it received for some or all of its partners, as well as information describing how effectively connected items are allocated among its partners, the lower-tier partnership shall look through the upper-tier partnership to the partners of the upper-tier partnership (to the extent that it has received the appropriate documentation and allocation information and can reliably associate the allocation of its effectively connected items to the partners of the upper-tier partnership) to determine its 1446 tax obligation. To the extent the lower-tier partnership receives a valid Form W-8IMY from the upper-tier partnership but cannot reliably associate the upper-tier partnership's allocable share of effectively connected partnership items with a withholding certificate for each of the upper-tier partnership's partners, the lower-tier partnership shall withhold at the higher of the applicable percentages in section 1446(b).

Therefore, in appropriate circumstances, the lower-tier partnership may determine its 1446 tax obligation based on the status of its indirect partners. This approach generally is consistent with the paperwork requirements under section 1441 applicable to a nonwithholding foreign partnership and will ensure that the 1446 tax paid by the partnership more closely approximates the actual tax liability of the beneficial owner of the income in the case of a tiered partnership structure. An upper-tier foreign partnership with foreign partners remains obligated to file and

report with respect to its 1446 tax obligation. Accordingly, the upper-tier partnership must comply with the general rules of section 1446, including requiring payment in installments, and reporting and passing along the credit under section 33 to its partners, which in these situations will also include the tax paid at the lower-tier partnership level.

Comments are requested on the general approach taken in these proposed regulations for situations involving two or more tiers of partnerships. Further, comments are requested as to the desirability and administrability of an alternative approach that allows a domestic upper-tier partnership with foreign partners to elect to pass information regarding its partners to the lower-tier partnership and have the lower-tier partnership pay the 1446 tax based upon the composition of the partners of the upper-tier partnership.

I. Withholding in Excess of Partner's Actual Tax Liability

Since the enactment of section 1446, Treasury and the IRS have received and considered several comments regarding the potential for section 1446 to require a partnership to pay a withholding tax in an amount that exceeds a foreign partner's actual tax liability for a taxable year. This situation may occur for several reasons, including that: (1) Section 1446 does not take into account a partner's losses from outside the partnership during the year, or a partner's loss carryovers; and (2) section 1446 requires withholding at the maximum statutory rates generally applicable to a foreign partner with effectively connected income. Section 1446 does not contain provisions for reducing or eliminating the general withholding obligation like the provisions contained in section 1445 (which impose a withholding tax in the case of the disposition of an interest in United States real property). See section 1445(c). Rev. Proc. 89-31 provides that section 1446 applies instead of section 1445(e)(1) where the two sections overlap, and, accordingly, partnerships owning U.S. real property are not permitted to reduce withholding on gains from the disposition of such property through the use of the procedures available under section 1445. See also § 8.01 of Rev. Proc. 2000-35 (2000-2 C.B. 211).

Treasury and the IRS considered comments regarding alternative approaches for adjusting the withholding tax obligation under section 1446 to more closely approximate a foreign partner's actual