

a copy of the Form 1042-S, "Foreign Person's U.S. Source Income Subject to Withholding," provided to the partner by the partnership.

(iii) *Tiered structures including trusts or estates*—(A) *Foreign trusts and estates*. Section 1446 tax paid on the portion of ECTI allocable under section 704 to a foreign trust or estate that the foreign trust or estate may claim as a credit under section 33 shall bear the same ratio to the total 1446 tax paid on behalf of the trust or estate as the total ECTI allocable to such trust or estate and not distributed (or treated as distributed) to the beneficiaries of such trust or estate, and, accordingly not deducted under section 651 or section 661 in calculating the trust or estate's taxable income, bears to the total ECTI allocable to such trust or estate. Any 1446 tax that a foreign trust or estate is not entitled to claim as a credit under this paragraph (d)(2) may be claimed as a credit by the beneficiary or beneficiaries of such trust or estate that includes the partnership's ECTI (distributed or deemed distributed) allocated to the trust or estate in gross income under section 652 or section 662 (with the same character as effectively connected income as in the hands of the trust or estate). The trust or estate must provide each beneficiary with a copy of the Form 8805 provided to it by the partnership and prepare the statement required by paragraph (d)(1)(iv) of this section.

(B) *Use of domestic trusts to circumvent section 1446*. This paragraph (d)(2)(iii)(B) shall apply if a partnership knows or has reason to know that a foreign person that is the ultimate beneficial owner of the ECTI holds its interest in the partnership through a domestic trust (and possibly other entities), 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. In such case, a partnership is required to pay 1446 tax under this paragraph as if the domestic trust was a foreign trust for purposes of section 1446 and the regulations thereunder. Accordingly, all applicable penalties and interest shall apply to the partnership for its failure to pay 1446 tax under this paragraph (d)(2)(iii)(B), commencing with the installment period during which the partnership knew or had reason to know that this paragraph (d)(2)(iii)(B) applied.

(iv) *Refunds to withholding agent*. A partnership (or nominee pursuant to

§ 1.1446-4) may apply for a refund of the 1446 tax paid only to the extent allowable under section 1464 and the regulations thereunder.

(v) *1446 tax treated as cash distribution to partners*. Amounts paid by a partnership under section 1446 with respect to a partner are treated as distributed to that partner on the earliest of the day on which such tax was paid by the partnership, the last day of the partnership taxable year for which the tax was paid, or, the last day during the partnership's taxable year on which the partner owned an interest in the partnership. Thus, for example, 1446 tax paid by a partnership after the close of a partnership taxable year that relates to ECTI allocable to a foreign partner for the prior taxable year will be considered distributed by the partnership to the respective foreign partner on the last day of the partnership's prior taxable year.

(vi) *Examples*. The following examples illustrate the application of this section:

*Example 1. Simple trust that reports entire amount of ECTI*. PRS is a partnership that has two partners, FT, a foreign trust, and A, a U.S. person. FT is a simple trust under section 651. FT and A each provide PRS with a valid Form W-8BEN and Form W-9, respectively. FT has one beneficiary, NRA, a nonresident alien individual. In computing its installment obligation during the 2004 taxable year, PRS has \$200 of annualized income, all of which is ordinary ECTI. The \$200 of income will be allocated equally to FT and A under section 704 and it is assumed that such an allocation will be respected under section 704(b) and the regulations thereunder. FT's allocable share of ECTI is \$100. PRS withholds \$35 under section 1446 with respect to the \$100 of ECTI allocable to FT. FT's only income for its tax year is the \$100 of income from PRS. Pursuant to the terms of the trust's governing instrument and local law, the \$100 of ECTI is not included in FT's fiduciary accounting income and the deemed distribution of the \$35 withholding tax paid under paragraph (d)(2)(v) of this section is not included in FT's fiduciary accounting income. Accordingly, the \$100 of ECTI is not income required to be distributed by FT, and FT may not claim a deduction under section 651 for this amount. FT must report the \$100 of ECTI in its gross income and may claim a credit under section 33 in the amount of \$35 for the 1446 tax paid by PRS. NRA is not required to include any of the ECTI in gross income and accordingly may not claim a credit for any amount of the \$35 of 1446 tax paid by PRS.

*Example 2. Simple trust that distributes a portion of ECTI to the beneficiary*.

Assume the same facts as in *Example 1*, except that PRS distributes \$60 to FT, which is included in FT's fiduciary accounting income under local law. FT will report the \$100 of ECTI in its gross income and may claim a deduction for the \$60 required to be

distributed under section 651(a) to NRA. Pursuant to paragraph (d)(2)(iii) of this section, FT may claim a credit under section 33 in the amount of \$14 for the 1446 tax paid by PRS (\$40/\$100 multiplied by \$35). NRA is required to include the \$60 of the ECTI in gross income under section 652 (as ECTI) and may claim a credit under section 33 in the amount of \$21 for the 1446 tax paid by PRS (\$35 less \$14 or \$60/\$100 multiplied by \$35).

*Example 3. Complex trust that distributes entire ECTI to the beneficiary*. Assume the same facts as in *Example 1*, except that FT is a complex trust under section 661. PRS distributes \$60 to FT, which is included in FT's fiduciary accounting income. FT distributes the \$60 of fiduciary accounting income to NRA and also properly distributes an additional \$40 to NRA from FT's principal. FT will report the \$100 of ECTI in its gross income and may deduct the \$60 required to be distributed to NRA under section 661(a)(1) and may deduct the \$40 distributed to NRA under section 661(a)(2). FT may not claim a credit under section 33 for any of the \$35 of 1446 tax paid by PRS. NRA is required to include \$100 of the ECTI in gross income under section 662 (as ECTI) and may claim a credit under section 33 in the amount of \$35 for the 1446 tax paid by PRS (\$35 less \$0).

(e) *Liability of partnership for failure to withhold*—(1) *In general*. Every partnership required to pay a 1446 tax is made liable for that tax by section 1461. Therefore, a partnership that is required to pay a 1446 tax but fails to do so, or pays less than the amount required under this section, is liable under section 1461 for the payment of the tax required to be withheld under chapter 3 of the Internal Revenue Code and the regulations thereunder unless the partnership can demonstrate pursuant to paragraph (e)(2) of this section, to the satisfaction of the Commissioner or his delegate, that the full amount of effectively connected taxable income allocable to such partner was included in income on the partner's U.S. Federal income tax return and the full amount of tax due on such return was paid by such partner to the Internal Revenue Service. See paragraph (e)(3) of this section and section 1463 regarding the partnership's liability for penalties and interest even though a foreign partner has satisfied the underlying tax liability. See § 1.1461-3 for applicable penalties when a partnership fails to pay 1446 tax. See paragraph (b) of this section for an addition to tax under section 6655 when there is an underpayment of 1446 tax.

(2) *Proof that tax liability has been satisfied*. Proof of payment of tax may be established for purposes of paragraph (e)(1) of this section on the basis of a Form 4669, "Statement of Payments Received," or such other form as the Internal Revenue Service may prescribe