MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

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Via Electronic Filing

Internal Revenue Service
CC:PA:LPD:PR (REG-105476-18)
Room 5203
P.O. Box 7604,
Ben Franklin Station
Washington, DC 20044.

Re: MFA Comments on IRS Proposed Regulation 105476-18, Withholding of Tax and Information Reporting with Respect to Interests in

Partnerships Engaged in the Conduct of a U.S. Trade or Business

Dear Ladies and Gentleman:

Managed Funds Association ("MFA")[1] appreciates the opportunity to provide comments in response to the proposed regulations, Withholding of Tax and Information Reporting with Respect to Interests in Partnerships Engaged in the Conduct of a U.S. Trade or Business (the "Proposed Regulations"), implementing section 1446(f) of the Internal Revenue Code of 1986, as amended (the "Code").[2] MFA is generally supportive of the approach taken in the Proposed Regulations to provide exceptions to the withholding requirements of section 1446(f). In particular, we welcome the approach taken in the Proposed Regulations to provide exceptions when: (1) a transferor of a partnership interest certifies its non-foreign status on Form W-9, (2) a transferor has no realized gains on the transfer of a partnership interest, and (3) a transferor has minimal amounts of effectively connected taxable income ("ECTI") for the three years prior to the "determination date."

Though we believe the Proposed Regulations provide an improved framework for implementing section 1446(f), we encourage the Department of the Treasury ("Treasury") and the Internal Revenue Service (the "IRS") to modify the Proposed Regulations to permit partnerships to minimize the risk of double withholding taxes by providing: (1) a look-through exception for indirect foreign partners who otherwise could qualify for one of the exceptions in the Proposed

[1] The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

[2] Section references in this letter refer to Code sections, unless otherwise indicated.

Regulations; (2) an exception for a foreign partnership that has provided a Form W-8IMY in which it has checked the box as a "withholding foreign partnership;" and (3) a mechanism for refunding any back-up withholding by a partnership once a transferor pay its tax liability under section 864(c)(8). Second, we encourage Treasury and the IRS to modify the exceptions in §1.1446(f)-2(b)(3)-(5) to avoid imposing withholding taxes when partnerships have little, if any, ECTI or when a transferor has an overall loss in connection with the transfer of its partnership interest. Third, we suggest modifying the methodology for determining a transferor's "amount realized" under the Proposed Regulations to avoid potential overwithholding on transfers of partnership interests when the partnership has liabilities. Finally, we encourage Treasury and the IRS to provide guidance on how to apply the Proposed Regulations in the context of earnouts, particularly with respect to application of the timing provisions in the relevant exceptions from withholding.

Minimizing Double Withholding

Look Through Exceptions for Foreign, Indirect Partners

Under §1.1446-2(c)(2)(ii)(C), a foreign partnership transferor may provide a Form W-8IMY (along with a withholding statement) to document when it has U.S. partners to obtain a modification of the "amount realized" for purposes of calculating any withholding tax required by the Proposed Regulations. The Proposed Regulations do not, however, provide a similar look-through approach with respect to foreign, indirect partners that could otherwise claim one of the exceptions to withholding such as the treaty exception, the nonrecognition exception, or the exception in case of absence of gain. As a result, foreign, indirect partners do not appear to be able to claim one of the exceptions to withholding in the Proposed Regulations, even if they would be eligible to claim such an exception if they were held as a direct interest in the partnership. We believe that Treasury and the IRS should provide guidance permitting a foreign partnership to provide appropriate documentation with respect to its foreign partners demonstrating when such indirect partners would qualify for one of the exceptions in the Proposed Regulations. If a foreign partnership transferor is able to provide such documentation, it should be permitted to obtain a modification of the "amount realized" for purposes of calculating any withholding tax due.

Withholding Foreign Partnerships

We also believe that a foreign partnership transferor, which provides a Form W-8IMY and has checked the box on the Form as a "withholding foreign partnership," should qualify for an exception to withholding under the Proposed Regulations, similar to a transferor that provides a Form W-9 in accordance with §1.1446(f)-2(b)(2). We are concerned that without such an exception, partners in upper-tier foreign partnerships that are withholding foreign partnerships could be subject to double withholding tax. We encourage Treasury and the IRS to amend the Proposed Regulations to provide an exception from withholding under the Proposed Regulations with respect to a transferor that is a withholding foreign partnership. To the extent Treasury and the IRS do not provide an exception from withholding under the Proposed Regulations with respect to foreign withholding partnerships, we encourage them to provide guidance that a "withholding foreign partnership" is not subject to additional withholding with respect to amounts withheld under the Proposed Regulations.

Refund Mechanism for Back-Up Withholding

Section 1446(f)(4) imposes a back-up withholding obligation on a partnership when the transferee fails to withhold as required under section 1446(f)(1). This back-up withholding obligation, however, neither removes the withholding obligation on the transferee nor the obligation on the transferor to pay any tax liability under section 864(c)(8). At the same time, the Proposed Regulations do not provide a mechanism for the transferee to receive a refund (either directly or through the partnership) for any back-up withholding tax once the transferor has paid its tax obligations under section 864(c)(8). To avoid double taxation, Treasury and the IRS should provide guidance on how a transferee can receive a refund under these circumstances.

Suggested Modifications to Exceptions from Withholding

No Realized Gain by Transferor (§1.1446(f)-2(b)(3))

We believe that §1.1446(f)-2(b)(3) provides an important and appropriate exception to requiring withholding taxes when a transferor provides a certification that it does not realize any gain in connection with the transfer of a partnership interest. We are concerned, however, about the inability of a transferor to provide a certification of no realized gain in certain circumstances when the transferor realizes a loss in connection with the transfer. In the preamble to the Proposed Regulations, Treasury and the IRS note that a transferor may not provide the certification of no realized gain required to qualify for the exception in §1.1446(f)-2(b)(3) if the transferor is required to realize ordinary income pursuant to section 751(a). This would appear to preclude a transferor from relying on (b)(3) even if the transferor would realize an overall loss on the transfer, taking into account any ordinary income under section 751(a). We believe that a transferor realizing an overall loss with respect to a transfer should be eligible for the exception in (b)(3), even if the transferor realizes some amount of ordinary income under section 751(a). We encourage Treasury and the IRS to modify the Proposed Regulations to permit a transferor to make a certification in such circumstances.

Less than Ten Percent ECTI (§1.1446(f)-2(b)(5))

Similar to the exception for no realized gain by a transferor, we believe that §1.1446(f)-2(b)(5) provides an important exception when a transferor provides a certification that the transferor's allocable ECTI from the partnership for each of the previous three years was less than $1 million and less than ten percent of the transferor's total distributive share of net income (among other requirements). We are concerned, however, with provisions in the Proposed Regulations that would prevent a transferor from making such a certification if the partnership has issued K-1s showing no net income for a given year or has not issued Form 8805 because the partnership did not have ECTI for a given year.

We believe that a transferor should be permitted to make a certification if it otherwise complies with the rule and was not issued a Form 8805 only because a partnership did not have ECTI in a given year. Permitting a transferor to make a certification when it did not receive a Form 8805 in a particular year because the partnership did not have ECTI is consistent with permitting a transferor to make a certification when it did not receive a Form 8805 because the partnership had an ECTI loss (as permitted by §1.1446(f)-2(b)(5)(iii)(B)). We encourage Treasury and the IRS to

modify §1.1446(f)-2(b)(5)(iii)(B) to apply either when a partnership has a loss that is effectively connected with a U.S. trade or business or the partnership has no ECTI in a given year.

We further believe that a transferor should be permitted to make a certification under §1.1446(f)-2(b)(5) if (along with the other requirements of the rule), in each of the three prior years, either (i) its allocable share of ECTI was less than ten percent of its share of net income or (ii) the partnership had no net income. Given the requirement in §1.1446(f)-2(b)(5)(i)(B) that a transferor has less than $1 million of ECTI from a partnership in each of the three prior years, we believe that the transferor should not be precluded from making a certification under this provision because the partnership had no net income or had a net loss in a particular year. The $1 million limit on ECTI ensures that a transferor may only make a certification under this provision when it receives minimal amounts of ECTI. We encourage Treasury and the IRS to amend §1.1446(f)-2(b)(5)(i)(C) to provide that the ten percent test will be deemed to have been met in any year that a partnership has no net income or a loss.

Under §1.1446(f)-2(b)(3) and (5), a partnership that is a transferee by reason of making a distribution may rely on its books and records, rather than a certification from the transferor to determine that the requirements of the rule have been met. We encourage Treasury and the IRS to modify these provisions to permit a partnership that is a transferee to rely on its books and records even if it is not making a distribution.

Effectively Connected Gain Upon a Partnership's Deemed Sale (§1.1446(f)-2(b)(4))

The exception in §1.1446(f)-2(b)(4) requires a partnership to make a determination as to the fair market value of all of its assets and the amount of net gain effectively connected with a trade or business in the U.S. as if it sold all of its assets as of the determination date. It may be difficult for certain partnerships to provide this certification given the inherent uncertainty in making valuation and ECTI calculations on unsold assets. We believe expanding the exceptions in §1.1446(f)-2(b)(3) and (5), as discussed above, would reduce the need to rely on the exception in (b)(3), as transferors in partnerships with overall losses or no realized ECTI amounts could rely on one of those exceptions instead. To facilitate the ability of partnerships to provide certifications under (b)(4), we encourage Treasury and the IRS to provide guidance that a partnership may base its certification on the same methodology it uses to value its assets and determine ECTI in the normal course of maintaining its books and records and reporting to partners.

Modify Determination of "Amount Realized"

We are concerned that including a partnership's liabilities in the definition of "amount realized" can yield uneconomic results and, therefore, we believe they should be excluded from the definition. §1.1446(f)-2(c)(2) defines the "amount realized" on the transfer of a partnership interest that is subject to withholding as the amount of cash paid (or to be paid), the fair market value of other property transferred (or to be transferred), the amount of any liabilities assumed by the transferee or to which the partnership interest is subject, and the reduction in the transferor's share of partnership liabilities. In the context of a distribution, the "amount realized" does not include any liabilities assumed by the transferee but includes the other amounts above. This rule could, under certain circumstances, require withholding of amounts greater than the cash and other property received. Treasury and the IRS recognized this concern in proposing §1.1446(f)-2(c)(2),

which places a cap on the amount of withholding at the amount realized without regard to the decrease in the transferor's share of partnership liabilities. We believe this cap demonstrates the uneconomic results that can occur by including a partnership's liabilities in the definition of "amount realized."

Further, while we appreciate that Treasury and the IRS provide a cap on withholding, we believe that potentially subjecting a transferor's entire amount of cash and property received to withholding still reflects overwithholding with respect to the economics of the transfer. Accordingly, we encourage Treasury and the IRS to modify the definition of "amount realized" to exclude partnership liabilities. We believe that Treasury and the IRS could use their anti-abuse authority to address situations where a transaction involving partnership liabilities has been inappropriately structured to evade withholding taxes under the rules.

To the extent Treasury and the IRS determine to include partnership liabilities in the definition of "amount realized," we welcome the change from Notice 2018-29 to provide that a transferee may generally rely on a certification if the last day of the partnership taxable year for which the Schedule K-1 showing the partnership liabilities was provided was no more than 22 months before the date of the transfer, instead of 10 months before the date of transfer, as provided in Notice 2018-29.

Earnouts

Transfers of a partnership interest may include an earnout provision, entitling the transferor to receive additional payments in the future based on the achievement of specified goals. It is unclear how the Proposed Regulations apply to such transactions, particularly with respect to the exceptions from withholding in §1.1446(f)-2(b)(3)-(5). We encourage Treasury and the IRS to provide guidance that, for purposes of determining the applicable testing periods in the exceptions in (b)(3)-(5), future payments under an earnout provision will qualify for an exception from withholding to the extent the original transfer of the partnership interest qualified for an exception under the rules.

MFA and its members would welcome an opportunity to meet with the staff from Treasury or the IRS to discuss these and any other issues in connection with implementation of the Proposed Regulations. If you have any questions regarding any of these comments, or if we can provide further information with respect to these or other issues, please do not hesitate to contact Benjamin Allensworth at (202) 730-2600.

Respectfully submitted,

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