CUMMINGS & LOCKWOOD LLC

THE IRS CLARIFIES THAT PRIVATE EQUITY, HEDGE FUNDS AND OTHER PARTNERSHIPS ARE SUBJECT TO WITHHOLDING REQUIREMENTS WHEN FOREIGN PERSONS ARE INVOLVED

May 22, 2019

On May 7, 2019, the IRS issued proposed regulations for new code section 1446(f), which requires withholding of income tax when a foreign person recognizes gain or loss from the sale or exchange of certain partnership interests, as described in IRC 864(c)(8). Such interests include limited partner interests in private equity and hedge funds. The proposed regulations provide further guidance regarding withholding of income tax and information reporting with respect to the disposition of an interest of a foreign investor in a partnership engaged in trade or business within the United States. The regulations will affect foreign investors, those that purchase interests from foreign investors, and the partnerships themselves (or entities taxed as partnerships) that, directly or indirectly, have foreign partners.

In a sale or exchange of a partnership engaged in a trade or business within the United States, transferees are required to withhold 10% of the amount realized unless the transferor provides an affidavit stating, under penalties of perjury, that the transferor is not a foreign person. Partnerships are also required to withhold tax from future distributions to transferees that were previously required to withhold tax but did not do so. The new regulations also address the withholding requirements for publicly traded partnerships, which require that the seller’s broker withhold the tax, rather than the transferee. Failure to properly withhold could result in penalties to the parties required to withhold.

The IRS is currently accepting comments on these proposed regulations until July 12, 2019. The regulations will be effective for transfers that occur on or after the date that is 60 days after the date the regulations are published as final in the Federal Register.