SALE OF PARTNERSHIP INTEREST BY FOREIGN PERSONS

Tax Cuts and Jobs Act of 2017 brings about many changes.

New Rules for Foreign Persons Selling Partnership Interests

The passing of comprehensive tax reform at the end of 2017 brought many changes. One change relates to the handling of the sale of partnership interests by foreign persons. Prior to the tax law change, withholding had not been required for the sale of a partnership interest by a foreign person. Under the law passed at the end of 2017, the purchaser of a partnership interest that is being sold by a foreign person is generally required to withhold 10% of the sales price of the partnership interest. This 10% withholding must be remitted to the Internal Revenue Service (IRS) no later than 20 days after closing.

For purposes of applying the withholding rules, a "foreign person" is defined as a nonresident alien individual, a foreign corporation, a foreign partnership, a foreign trust or a foreign estate. A resident alien individual, including a nonresident alien electing to be treated as a U.S. resident, is not a foreign person.

Background

Prior to the passing of the new law, the U.S. taxation on the sale of a partnership interest by a foreign person was not clearly defined. The law signed into effect on December 22, 2017, commonly known as the Tax Cuts and Jobs Act of 2017, added new code sections that impose both a withholding tax and substantive tax on the sale of certain partnership interests by foreign persons.

Explanation of Witholding and Substantive Tax

The withholding tax requires a 10% withholding on the sales price of a partnership interest by foreign persons unless certain exceptions are met. The 10% withholding, similar to the 15% Foreign Investment in Real Property Act of 1980 (FIRPTA) withholding on sales of U.S. real property interests by foreign persons, is computed on the gross sales price of the partnership interest, not the amount of any underlying gain. This withholding is not a true "tax" but rather a retention of funds to be sent to the IRS intended to cover the substantive tax described below.

As written, this new withholding requirement is in effect for transactions after December 31, 2017.

In addition, if a taxpayer takes distributions of money or property from a partnership in excess of basis, even without selling his or her interest in the partnership, the taxpayer is subject to withholding and substantive tax, unless exceptions are met.

The substantive tax is assessed on any gain from the sale of the partner's interest in the partnership which is considered to be effectively connected with a U.S. trade or business. For purposes of this tax, it treats the sale as if the partnership had sold all of its U.S. assets at their fair market values as of the date of the sale of the partnership interest. The substantive (actual) tax is calculated on the tax return reporting the sale of the partnership interest. The amount of withholding is compared to the actual tax on the sale. If the tax is less than the withholding, the difference is refunded to the seller. If the tax is more than the withholding, the seller must pay the difference to the IRS.

This tax applies on the sale, exchange or disposition of partnership interests on or after November 27, 2017.

Beginning November 27, 2017 and through December 31, 2017, no withholding was required on the sale of a partnership interest to a foreign person, even though a substantive tax may ultimately be due with the filing of the tax return.

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Under the current guidance, the Treasury Department and the IRS have suspended the requirement to withhold on dispositions of certain interests in publicly traded partnerships.

Compliance with Witholding and Tax

The withholding agent (transferee/buyer) is responsible for having the withholding tax collected and remitted to the IRS from the proceeds of the sale. In the case of a sale or exchange, the withholding agent is the purchaser of the partnership interest. In the case of a distribution in excess of basis, the withholding agent is the taxpayer.

Compliance with the withholding requirements on the disposition of a partnership interest is handled similarly to the FIRPTA withholding done on the sale of U.S. real property interests by foreign persons. As with FIRPTA, the withholding tax must generally be paid and the forms filed within 20 days of the date of disposition.

Under the new law if the buyer fails to withhold the partnership has an obligation to do so. This rule is suspended under current guidance until regulations or other guidance have been issued.

The calculation and payment of the substantive tax is done with the filing of the tax return for the taxpayer.

Additional Information

Income tax treaties may be available for certain taxpayers and can be utilized in appropriate circumstances to assert that gain from the sale of a partnership interest is not subject to U.S. federal income tax. It is beyond the scope of this article to cover the application of these income tax treaties.

This article discusses some aspects of the sale of certain partnership interests by foreign persons. It is not intended to address all possible facts and circumstances, nor is it intended to address all the issues related to foreign persons selling partnership interests. Every situation is unique and it is important to consult a qualified tax advisor who has the requisite experience to assist you with your tax filing and disclosure requirements. We are happy to advise you on how to comply with these requirements.

To discuss your international tax and financial planning needs, contact **David Cumberland, Tax Manager**, at (941) 365-4617 or by email at dcumberland@kbgrp.com.

Kerkering, Barberio & Co., CPAs has been a part of the Tampa Bay community for over 40 years, and is one of Southwest Florida's largest independent CPA firms. Providing a variety of tax, audit and accounting services to businesses and individuals, KB brings together the best people, quality services and innovative products to assist clients in achieving their personal, business and financial goals.

MEET THE ACCOUNTANT
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David A. Cumberland, CPA/CGMA, joined the firm in 2014. David primarily practices in the area of inbound international tax work covering both individual and business tax preparation and consulting. Mr. Cumberland is fluent in Spanish and his emphasis is with international clients or clients with international considerations.

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