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Proposed regulations: Interplay of centralized partnership audit regime and international tax rules

The U.S. Treasury Department and IRS today released for publication in the Federal Register a notice of proposed rulemaking (REG-119337-17) containing proposed regulations addressing how certain international tax rules operate under the U.S. centralized partnership audit regime.

Today's **proposed regulations** [PDF 269 KB] include measures relating to tax withholding on foreign persons and tax withholding to enforce reporting on certain foreign accounts, as well as rules concerning the treatment of creditable foreign tax expenditures of a partnership. The topics addressed in today's proposed regulations include:

- Provisions related to chapters 3 and 4 of subtitle A of the Code (in general, withholding tax rules)
- Provisions related to creditable foreign tax expenditures and foreign tax credits
- Discussions related to treaties and reductions to the rate of tax on foreign persons
- Measures related to certain foreign corporations

Background

Proposed regulations issued in June 2017 concerned implementation of the centralized partnership audit rules and, in general, the assessment and collection of tax at the partnership level under the new partnership audit rules. The June 2017 proposed regulations were substantially similar to regulations that were proposed in January 2017 and subsequently withdrawn. The June 2017 proposed regulations included:

- Procedures for electing out of the centralized partnership audit regime
- Procedures for filing administrative adjustment requests

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- Rules for determining amounts owed by the partnership or its partners attributable to adjustments that arise out of an examination of a partnership

The January 2017 draft "reserved" on the issue as to whether a pass-through partner could elect to push out the adjustment to higher tiers. Today's proposed regulations also reserve on this issue, but add that Treasury and the IRS are considering allowing such a push-out of the adjustment beyond the first tier partners and that proposed regulations addressing that issue will be published "in the near future." Read ***TaxNewsFlash-United States***

The preamble to today's proposed regulations explains that these regulations are supplementing the June 2017 proposed regulations, and that the IRS and Treasury intend to integrate the proposed regulations when they are finalized.

Coordinating the centralized partnership audit regime with chapters 3 and 4

In the preamble, the IRS and Treasury explained that the June 2017 proposed regulations provided that taxes not covered by the centralized partnership audit regime—including taxes imposed by chapters 3 and 4—would continue to be examined in a proceeding outside of the centralized partnership audit regime.

The preamble notes that a partnership that receives a payment or has income allocable to a partner that is a foreign partner, a foreign financial institution (FFI) or a nonfinancial foreign entity (NFFI) may have withholding requirements under chapters 3 and 4. The proposed regulations include coordination rules to clarify how the centralized partnership audit regime interacts with the partnership's obligations under chapters 3 and 4 and also for determining that tax is only collected once with respect to the same item of income. Examples are provided to illustrate what happens when:

- A partnership fails to withhold tax at the correct rate on an item of income allocable to a foreign partner
- A partnership fails to report an item of income and, thus, also fails to withhold tax on the additional income allocable to a foreign partner

The proposed regulations also include measures to determine that tax is only collected once with respect to the same adjustment. When the IRS has not collected tax under chapter 3 or 4 on an amount subject to withholding and the partnership subject to examination under the centralized audit partnership regime, the partnership will be considered to have satisfied its withholding tax liability associated with the adjustment if it pays the imputed underpayment and the total netted partnership adjustment includes the amount subject to withholding under chapter 3 or 4. The partnership may still be liable for interest, penalties or additions to tax.

Today's proposed regulations also address the withholding and reporting requirements under chapters 3 and 4 when the partnership elects to "push out" adjustments to its "reviewed year" partners under section 6226 (instead of paying an

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imputed underpayment amount). Under the proposed regulations, a partnership that makes a section 6226 election must pay the withholding tax (that is, the amount of tax required to be withheld under chapters 3 and 4) on any adjustment allocable to a reviewed year partner that would have been subject to withholding in the reviewed year. The proposed regulations address how (in what manner) and when these withholding taxes are to be paid. There are measures that allow the amount of withholding tax to be reduced to the extent the reviewed year partner provides documentation that it is entitled to a reduced rate of withholding tax under chapters 3 and 4.

Other provisions in the proposed regulations address the return filing requirements for the reviewed year partner, potential credits available under section 33, and related reporting requirements.

The preamble notes that the IRS and Treasury are considering additional ways to alleviate the filing obligations for foreign persons when a partnership pushes out its adjustment and does not make a specific imputed underpayment for adjustment subject to withholding tax. For example, one consideration is the treatment afforded the partner when the partnership pays the share of penalties, addition to tax, interest, and other amounts attributable to a partner that would have been subject to withholding in the reviewed year. Comments are requested regarding these proposed approaches. Additionally, comments are requested regarding the application of chapters 3 and 4 to section 6226 in the case of partners that are foreign flow-through entities (including withholding foreign partnerships and withholding foreign trusts).

Provisions related to U.S. foreign tax credits

A very preliminary review notes that the preamble explains that neither the statutory text of the centralized partnership audit regime nor an explanation from the Joint Committee on Taxation addresses coordination of these rules with the foreign tax credit (FTC) rules.

Thus, the proposed regulations reflect the IRS and Treasury position that the FTC rules “should be preserved while implementing the broader purpose of the centralized partnership audit regime.” Today’s proposed regulations includes guidance concerning:

- The treatment of creditable foreign tax expenditures (CFTE) under the imputed underpayment provisions of the centralized partnership audit regime
- Application of the FTC limitation of partners in a partnership subject to the centralized partnership audit regime
- Certain special procedural FTC rules and the treatment of credits under section 902 and 960 (that are not themselves items of the partnership, but affect the calculation of certain items of the partnership)

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Today's proposed regulations include guidance concerning adjustments that affect the category or amount of CFTEs of a partnership, and there are examples provided to illustrate this guidance.

Comments requested

Scattered throughout the preamble to today's proposed regulations are statements that the IRS and Treasury are still considering the approaches to take with regards to certain issues. For instance:

- Comments are requested on these and any other issues regarding the coordination of the FTC regime and the centralized partnership audit regime.

- Comments are specifically requested on the application of the netting rules to CFTEs and the related computation of the imputed underpayment, and regarding circumstances when the grouping and subgrouping of CFTE adjustments could be improved while preserving the FTC limitation rule.

- The proposed regulations continue to reserve the rules on creditable expenditures other than CFTEs, and comments are requested as to whether special rules are needed in this regard.

- Comments are requested about foreign taxes deemed paid under sections 902 and 960 and how the information-reporting requirement could be crafted to minimize compliance costs and burdens.

- Comments are requested about how the IRS could adjust credits for deemed paid foreign taxes at either the partnership or partner level without creating unreasonable distortions or burdens.

- Comments are requested concerning the modification of an imputed underpayment based on the status of a foreign partner and other treaty issues.

The preamble notes that comments and requests for a public hearing are due by a date that is 60 days after the publication of the proposed regulations in the Federal Register, which is scheduled for November 30, 2017.

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