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February 2, 2006

Mr. Eric Solomon
Acting Deputy Assistant Secretary (Tax Policy)
Department of the Treasury
Room 3112 MT
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

The Honorable Mark W. Everson
Commissioner
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Final and Temporary Section 1446 Regulations
Regarding Withholding on Allocations of
Effectively-Connected Taxable
Income to Foreign Partners

Dear Acting Deputy Assistant Secretary Solomon and Commissioner Everson:

I am pleased to submit the New York State Bar Association Tax Section's Report No. 1103 (the "Report") on the final, temporary and proposed Treasury Regulations issued under section 1446 of the Internal Revenue Code, relating to the withholding by partnerships of U.S. tax on allocations of effectively-connected taxable income to foreign partners. We commend the Treasury and the Service for issuing these regulations, which provide welcome clarity and guidance on the application of section 1446.

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The Report addresses two aspects of the final regulations, the treatment of cancellation of indebtedness (“COD”) income and the overlap between the section 1446 withholding rules and the FIRPTA withholding rules contained in section 1445. The Report also addresses temporary and proposed regulations (section 1.1446-6T) that permit a partnership to adjust the amount of tax it withholds under section 1446 to reflect certain losses or other attributes of a foreign partner.

The final regulations provide no relief from withholding in respect of COD income. We concur with the Treasury’s and the Service’s decision not to provide relief in this case, because we believe that the statutory withholding requirement is clear and that the policy underlying section 1446 can be interpreted to support that decision. However, we believe that requiring partnerships to withhold on COD income under section 1446 raises complex and difficult policy issues that merit further consideration. We therefore include a detailed discussion of these issues for your consideration.

The final regulations also provide that, in the case of a disposition of a U.S. real property interest (a “USRPI”) by a domestic partnership, which is potentially subject to the FIRPTA withholding rules under section 1445(e)(1) as well as to withholding under section 1446, the section 1446 rules prevail. We believe that this “trumping rule” reaches a result inconsistent with the statute in the case of a USRPI that is not held by the partnership in connection with a U.S. trade or business. The Report therefore recommends that, in this situation, section 1445 rather than section 1446 should apply. Where the USRPI is held by the partnership in connection with a U.S. trade or business, we believe that both section 1445 and section 1446 potentially apply and that the Treasury and the Service have authority to determine which set of rules should prevail. If consistent treatment of dispositions of real property were deemed desirable, the Treasury and the Service may wish to consider applying section 1445 in this situation also. The Report does not recommend whether section 1445 or section 1446 should apply in this situation but discusses some of the relevant policy considerations.

The temporary and proposed regulations under section 1.1446-6T permit a partnership to adjust the amount of tax it withholds under section 1446 to reflect certain losses or other attributes of a foreign partner if the foreign partner meets a number of requirements and certifies to the partnership that these requirements are met. We support the adoption of this regulation and believe that adjusting the amount that a partnership must withhold to more closely approximate the tax that its foreign partners ultimately will owe significantly improves the section 1446 withholding regime. As currently drafted, however, these regulations provide only limited protection to a partnership that withholds in reliance on a certificate provided by a foreign partner, even if the partnership has no reason to question the validity of the certificate. Further, the conditions that must be met for a foreign partner to provide a valid certificate are extremely detailed and complex. We are concerned that the combination of limited protection for the partnership and complex procedural

requirements and restrictions will discourage many partnerships from taking advantage of the regulations in their current form.

The Report recommends that a partnership that reasonably relies on a certificate should be relieved of liability, not only for the addition to tax under section 6655, but also for the section 1446 withholding tax and interest. Whether or not the Treasury and the Service adopt this suggestion, we believe that the procedural requirements and restrictions should be simplified. Because a partnership is not required to take into account a certificate from a foreign partner, we do not think that the many detailed procedural requirements contained in the regulations are necessary to protect partnerships. We also do not believe that simplifying the requirements would materially increase the risk of underwithholding. The Report therefore recommends a number of specific simplifying changes to the procedural requirements.

We appreciate your consideration of our comments and would be pleased to discuss them with you further. We would be happy, as well, to provide any other assistance that you would find helpful.

Respectfully submitted,



Kimberly S. Blanchard
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