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Report No. 1493
May 29, 2024

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Re: Report No. 1493 – Request for Guidance on the Procedure for Filing
a Protective Return in Respect of Section 1446 Withholding Tax in Light
of YA Global¹

Dear Mses. Aron-Dine and Rollinson, and Messrs. Werfel and Paul:

We are writing to request guidance on the means by which a partnership that believes it does not have income effectively connected with a U.S. trade or business (“effectively connected income”) may file a protective IRS Form 8804, “Annual Return for Partnership Withholding Tax (Section 1446),” or other protective form, that would commence the

¹ The principal drafters of this letter are Megan Brackney, Daniel Hanna and Yaron Reich. Helpful comments were received from Edward Gonzalez, Robert Kantowitz, Jiyeon Lee-Lim, Michael Schler, Vikram Sharma, Shun Tosaka and Libin Zhang. This letter reflects solely the views of the Tax Section of the New York State Bar Association and not those of the New York State Bar Association Executive Committee or its House of Delegates.

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running of the statute of limitations in respect of the Section 1446 withholding tax, in light of *YA Global v. Commissioner*.² We are concerned that, notwithstanding *YA Global*'s directive that taxpayers should file an IRS Form 8804 on a protective basis in order to commence the running of the statute of limitations, there is currently no formal procedure for taxpayers to do so. There is similarly no means for the IRS to distinguish between protective returns and routine filings. And, as noted below, we question whether filing a protective Form 8804 is the most appropriate procedure as a matter of sound tax administration.

The filing of a return is essential for taxpayers seeking to ensure compliance, commence the running of the statute of limitations, and avoid additions to tax for failure to file a return. The statute of limitations for assessing a tax generally extends for three years after the return is filed.³ In the case of a failure to file a return, the tax may be assessed at any time (*i.e.*, the statute for assessing the tax never closes).⁴ A taxpayer may also be subject to additions to tax under Section 6651(a)(1) if it fails to file "any return" that is required to be filed under relevant provisions of subchapter A of chapter 61 of the Code, unless the failure is due to reasonable cause.

In *YA Global*, the Tax Court held that the taxpayer's filing of an IRS Form 1065, "U.S. Return of Partnership Income," was insufficient to commence the running of the statute of limitations in respect of the Section 1446 withholding tax. The court stated that, for this purpose, an IRS Form 1065 is not a substitute return for a Form 8804. Instead, the relevant "return" that starts the three-year statute of limitations for Section 1446 withholding tax purposes is the IRS Form 8804.⁵ As a result, under the approach of *YA Global*, if a domestic or foreign partnership believes it is not engaged in a U.S. trade or business but would like to commence the running of the statute of limitations (and protect itself from additions to tax) in respect of the Section 1446 withholding tax, it would need to file a protective IRS Form 8804, in addition to filing an IRS Form 1065 to commence the running of the statute of limitations for income tax purposes (which, in order to avoid penalties, should generally include an IRS Form 8275 disclosing its position that it does not

² *YA Global Investments, LP v. Comm'r*, 161 T.C. No. 11, Docket Nos. 14546-15 *et al.*, (Nov. 15, 2023). Section 1446 imposes a withholding tax on a partnership that has effectively connected income that is allocable to a foreign partner, which tax the foreign partner may credit against its income tax liability. All Section references are to the Internal Revenue Code of 1986, as amended (the "Code") or to the Treasury regulations promulgated thereunder.

³ Section 6501(a).

⁴ Section 6501(c)(3).

⁵ *YA Global Investments*, 161 T.C. No. 11, pp. 85 – 89 (Nov. 15, 2023) (slip op.). The court also concluded that in any event the IRS Form 1065 filed by the taxpayer was inadequate to commence the running of the statute of limitations on its Section 1446 withholding liability because that return did not disclose the key fact that the taxpayer was engaged in a U.S. trade or business. *Id.* at pp. 85-86. While *YA Global* involved tax years at issue that predate the enactment of the Bipartisan Budget Act of 2018 (the "BBA") and its enactment of a new, centralized audit regime applicable to partnerships, the protective IRS Form 8804 considerations raised in *YA Global* remain relevant under current law.

have effectively connected income, unless the position is supported by substantial authority).

Notwithstanding *YA Global's* directive, there is currently no formal procedure for filing an IRS Form 8804 on a protective basis. Instead, the Section 1446 regulations – and the instructions to IRS Form 8804 – simply state that a partnership is required to file an IRS Form 8804 if it has effectively connected gross income.⁶ The IRS Form 8804 itself is not formatted in a way that allows taxpayers to identify the return as a protective return. The instructions provide no guidance on the type of statement to attach to an IRS Form 8804 being filed on a protective basis, or how to indicate that the form itself is a protective return. The IRS similarly has no ready means of distinguishing a routine IRS Form 8804 filed by a partnership with effectively connected gross income (or net loss) from one filed on a protective basis.

By contrast, there is a clear procedure for foreign corporations seeking to file a protective IRS Form 1120-F. Under Treasury Regulations Section 1.882-4(a)(3)(vi), a foreign corporation that believes it does not have effectively connected income can file an IRS Form 1120-F that reports no effectively connected income and includes a statement indicating that the return is a protective return filed in accordance with the regulation.⁷ Moreover, the IRS Form 1120-F contains a box for taxpayers to check, indicating that it is a “protective return.”⁸ As a result, the IRS can easily distinguish between a protective IRS Form 1120-F – one with the appropriate box marked on the return and an accompanying statement – from a routine IRS Form 1120-F.

A domestic partnership generally must file an IRS Form 1065 unless it neither receives income nor incurs any expenditures treated as deductions or credits for federal income tax purposes.⁹ If the partnership believes it does not have effectively connected income, it can generally avoid the imposition of penalties for understatement of income, where the position is not supported by substantial authority, by disclosing its position on an IRS Form 8275.¹⁰ Subject to certain exceptions, a foreign partnership that has effectively connected income, gross income from U.S. sources or U.S. partners must file an IRS Form 1065.¹¹ There is no clear procedure for a foreign partnership that believes it does not have effectively connected income to file a protective return in order to avoid the imposition of

⁶ Treasury Regulations Section 1.1446-3(d)(iii); <https://www.irs.gov/instructions/i8804>.

⁷ The protective IRS Form 1120-F not only preserves the right to claim deductions, but also commences the running of the statute of limitations. *See* Section 6501(c)(3).

⁸ *See* IRS Form 1120-F (including a “Protective return” checkbox on the top of the form).

⁹ Treasury Regulations Section 1.6031(a)-1(a); <https://www.irs.gov/instructions/i1065>.

¹⁰ Section 6662(d)(2)(B); Treasury Regulations Section 1.6662-4(e), (f).

¹¹ Treasury Regulations Section 1.6031(a)-1(b); <https://www.irs.gov/instructions/i1065>.

penalties,¹² although presumably it can file an IRS Form 1065 with no amounts entered on the form and (in the absence of substantial authority) attach an IRS Form 8275 disclosing its position.

We respectfully request that Treasury and the IRS issue guidance that clarifies the means by which taxpayers who believe they do not have effectively connected income may file an IRS Form 8804 on a protective basis or otherwise commence the running of the statute of limitations in respect of Section 1446. In issuing that guidance, Treasury and the IRS could consider at least two potential approaches:

One approach would be to adopt the procedures set forth in Treasury Regulations Section 1.882-4(a)(3)(vi) with respect to IRS Form 8804. The guidance would include an updated IRS Form 8804 that allows taxpayers to clearly indicate on the form – and for the IRS to easily identify – that it is a protective return (similar to the IRS Form 1120-F). Following this guidance, a taxpayer would file an IRS Form 8804 on a protective basis by marking the appropriate box on the form and attaching a statement to the IRS Form 8804 similar to the one described in Treasury Regulations Section 1.882-4(a)(3)(vi).

If this approach is adopted, it may be appropriate for the guidance to provide that the filing of an IRS Form 8804 on a protective basis by a partnership that believes that it does not have effectively connected income would also serve as disclosure for purposes of commencing the running of the statute of limitations (and avoiding penalties) relating to the partnership's failure to file an IRS Form 1065 (or an IRS Form 8275, if appropriate) in respect of effectively connected income, in lieu of also having to file a protective IRS Form 1065 (pursuant to guidance to be issued) or to include an IRS Form 8275, if appropriate, with an IRS Form 1065 that it is otherwise filing. This approach would (appropriately) prevent the IRS from commencing a BBA income tax proceeding in respect of the effectively connected income issue even though the partnership filed an IRS Form 8804 on a protective basis in respect of the Section 1446 withholding tax on effectively connected income (*i.e.*, the converse of the IRS' successful argument in *YA Global*). However, the filing of a Form 8804 on a protective basis should not start the statute of limitations for any issue other than a foreign partner's effectively connected income (such as the withholding tax under Sections 1441 and 1442 in respect of FDAP income or any BBA audit of the income allocable to U.S. partners). We note, though, that it would be unusual for the statute of limitations to apply in this manner, to only one issue under a tax return. For this and other reasons set forth below, we recommend that Treasury and the IRS adopt an alternative approach.

The alternative approach – which we recommend – would be for Treasury and the IRS to permit taxpayers to satisfy the protective filing requirement for IRS Form 8804 (as well as any disclosure requirement to avoid the imposition of penalties in respect of IRS Form 1065) by checking a box on IRS Form 1065 and attaching a statement similar to the

¹² In general, under the BBA, penalties are determined at the partnership level (Section 6233(a)(3)), and are imposed either on the partnership or the partners, depending on whether a “push out election” is made (*see* Section 6226(c)(1)).

one described in Treasury Regulations Section 1.882-4(a)(3)(vi) (in lieu of filing an IRS Form 8804). We acknowledge that IRS Form 8804 is distinct from IRS Form 1065 and is typically filed separately (and not as part of the partnership's IRS Form 1065).¹³ However, we see no reason why a protective return would need to follow the same procedural requirements as a routine IRS Form 8804. In fact, it would appear that there is a significant administrative benefit to permitting these filings to be made by way of a statement attached to the IRS Form 1065. This approach would reduce the volume of IRS forms that are filed and would require fewer IRS resources to process the forms. Moreover, the Section 1446 withholding tax is a means of enforcing the income tax on foreign partners who have effectively connected income from a partnership, and thus is directly relevant to issues that would be reviewed by IRS international auditors as part of an audit of partnership income tax issues, rather than by withholding tax auditors. Therefore, it would seem to be more helpful for the IRS if the issue is identified on the partnership's Form 1065 rather than on Form 8804. Finally, having IRS Form 1065, rather than IRS Form 8804, serve as the vehicle for filing a protective return regarding effectively connected income provides a more conventional rule for starting the running of the statute of limitations on both Forms, as compared to the approach discussed above if the protective filing is made on IRS Form 8804.

In requesting this guidance, we are not commenting as to whether and under what circumstances, under existing case law, the filing of an IRS Form 1065 may commence the running of the statute of limitations in respect of Section 1446 withholding tax.¹⁴ Instead, we are simply requesting that should a taxpayer wish to file a protective return consistent with the *YA Global* decision, the Treasury and the IRS offer those taxpayers a clear procedure to do so.¹⁵

We appreciate your consideration of our request. If you have any questions or comments, please feel free to contact us and we will be glad to assist in any way.

¹³ Treasury Regulations Section 1.1446-3(d)(iii).

¹⁴ We note, however, that the *YA Global* court's application of the standard articulated in the case law regarding the adequacy of filing a return to commence the running of the statute of limitations appears to be more rigid than the Fifth Circuit's approach in *Quezada v. IRS*, 982 F.3d 931 (5 Cir. 2020), *non-acq.*, 2022-6 IRB 466.

¹⁵ In general, such guidance would also cover partnership-level withholding tax under Section 1445 (in respect of a foreign partner's distributive share of gain from a domestic partnership's disposition of U.S. real property interests) since such amounts are reported on IRS Form 8804. See <https://www.irs.gov/instructions/i8804>. Consideration might also be given to whether similar guidance should address partnership-level withholding tax on a partner's distributive share of FDAP income under Sections 1441 and 1442, reported on IRS Form 1042.

Respectfully submitted,



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Chair

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