

THE ASSOCIATION OF GLOBAL CUSTODIANS

THE BANK OF NEW YORK MELLON CORPORATION
BROWN BROTHERS HARRIMAN
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HSBC SECURITIES SERVICES
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March 22, 2010

Via Courier

Courier Desk
Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2009-43)
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Custodian Withholding Obligations With Respect to Distributions by Publicly Traded Partnerships – Need for Guidance

Dear Sir or Madam:

We write on behalf of the Association of Global Custodians (the "Association" or the "AGC") and its member banks,¹ to submit for your consideration the attached request for guidance prepared by an Association task force on custodian withholding obligations with respect to distributions by publicly traded partnerships.

The Association respectfully requests the issuance of guidance regarding the withholding obligations of a custodian holding an interest in a publicly traded partnership to withhold tax from a distribution to a foreign partner. This guidance is urgently needed to clarify certain interpretive issues not clearly resolved by current guidance. These regulatory gaps lead to uncertainty for custodians and investors, potential withholding tax exposure for custodians, and potential over-withholding on distributions from publicly

¹ The Association is an informal group of nine global custodian banks that provide securities safekeeping services and related asset-servicing functions to cross-border institutional investors, including pension funds, insurance companies, and investment companies, many of which are organized in the United States. Members of the Association are listed on the letterhead above. As intermediary custodians, Association members operating in the United States necessarily act as withholding agents with respect to U.S. source income distributed in connection with customers' securities holdings. It is estimated that Association members hold in custody investor assets valued in excess of \$US 45 trillion.

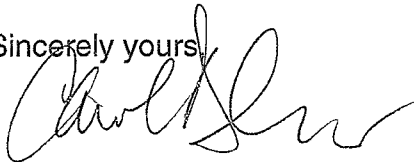
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traded partnerships. The issuance of the requested guidance would resolve significant issues relevant to custodians generally, promote sound tax administration, enable custodians and the Service to administer the law uniformly and efficiently, and reduce potential controversy. We would ask, therefore, that this item be added to the 2009-2010 Priority Guidance Plan at its next periodic update and that guidance, including temporary interim guidance if appropriate, be issued as quickly as possible.

The attached memorandum provides background and additional details for your consideration. The Association would appreciate an opportunity to meet with the responsible IRS and Treasury Department officials to discuss these issues. In the meantime, please do not hesitate to contact me at (202) 452-7049 if you have questions or need any further information.

Sincerely yours,



Carol A. Dunahoo
Baker & McKenzie LLP
Counsel to the Association of Global Custodians

cc: Steven Musher
Associate Chief Counsel (International)
Internal Revenue Service

Michael Danilack
Deputy Commissioner (International)
Internal Revenue Service

Manal Corwin
International Tax Counsel
Department of the Treasury

Attachment

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Attachment to the Letter of March 22, 2010

Association of Global Custodians' Request for Guidance on Publicly Traded Partnership Withholding Issues

Background

The Code imposes two sets of withholding obligations that are potentially applicable to custodians holding interests in publicly traded partnerships (“PTPs”)¹ as nominees for foreign partners. First, Sections 1441 and 1442 generally impose a withholding obligation with respect to items of U.S. source “fixed or determinable annual or periodical gains, profits, or income” (“FDAP”) of nonresident alien individuals, foreign partnerships, and foreign corporations. FDAP consists largely of income items such as dividends, interest, rents, and royalties, but generally does not include income “effectively connected” with the conduct of a trade or business within the United States (“ECI”).² Unless a statutory exemption applies, tax must be withheld on FDAP either at the general statutory rate of 30 percent or at a reduced treaty rate, if applicable. Any person with control, receipt, custody, disposal, or payment of an item of U.S. source FDAP of a foreign person covered by Section 1441 or 1442 may be a withholding agent for purposes of those Sections.

Second, Section 1446 imposes a withholding tax on the foreign partners’ allocable share of the partnership’s effectively connected income, gain, or loss. In the case of PTPs, the tax is withheld from distributions to foreign partners at the highest applicable statutory rate.³ The PTP generally is responsible for withholding any tax due

¹ The term “publicly traded partnership” refers to an entity treated as a partnership under section 7704(c) of the Internal Revenue Code of 1986, as amended (the “Code”). Unless otherwise indicated, all section references herein are to the Code or to the Treasury Regulations promulgated thereunder.

² Code § 1441(c)(1).

³ Treas. Reg. § 1.1446-4(a), (b)(2).

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under Section 1446; however, a domestic person that holds an interest in a PTP on behalf of a foreign person is considered a nominee and may be treated as the sole withholding agent for purposes of Section 1446.⁴

The Association of Global Custodians (“AGC”) respectfully submits that the withholding and reporting obligations on distributions with respect to a PTP interest held by a custodian acting as a nominee on behalf of a foreign partner are not adequately clarified under current guidance. The resulting regulatory gaps and ambiguities create uncertainty for custodians and investors, potential withholding tax exposure for custodians, and a risk of overwithholding on PTP distributions to investors.

Current PTP market conditions

Many PTPs pay regular distributions to their partners. Most PTPs do not release any tax information at the time the amounts are distributed, and there is not currently a market mechanism or facility used by PTPs to distribute information about the tax character of their distributions. Nor is there a practice in place among PTPs to provide such information to the market at the time of a distribution.

PTPs are required to issue Schedules K-1 to their partners. In our experience, certain PTPs report some ECI on their Schedules K-1. Others indicate in their offering documents that the PTP will not be engaged in any U.S. trade or business that will generate ECI. However, the Schedules K-1 are not available until at least several months after the close of the calendar year, and are sent directly to the partners. Therefore, even when relevant information is provided on the Schedule K-1, it is not available to custodians at the time that they must determine their tax withholding and reporting obligations.

Interpretive issues regarding current nominee withholding and reporting requirements

For purposes of Section 1446, a custodian is treated as a nominee with respect to an interest it holds in a PTP on behalf of a foreign partner.⁵ A nominee is treated as a withholding agent with respect to distributions by the PTP that are subject to withholding under Section 1446, but only to “the extent of the amount specified in the

⁴ Treas. Reg. § 1.1446-4(b)(3), (d).

⁵ Treas. Reg. § 1.1446-4(b)(3).

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qualified notice.”⁶ Section 1.1446-4 defines a qualified notice (“QN”) as a notice given by a PTP “regarding a distribution that is attributable to effectively connected income, gain or loss of the partnership, and published in accordance with the notice requirements with respect to dividends described in 17 C.F.R. 240.10b-17(1) or (3) issued pursuant to the Securities Exchange Act of 1934 (15 U.S.C. §78a).”⁷

For the reasons discussed below, nominees find the QN provisions of the current regulations difficult to apply in practice. As a result, it is often not clear whether a nominee may be treated as a withholding agent under Section 1446.

Issues Regarding the Content of the “Qualified Notice”

A nominee is treated as receiving a QN with respect to a distribution at the time the PTP publishes a notice of the distribution in accordance with the requirements of 17 CFR 240.10b-17(b)(1) or (3). When the PTP publishes a notice in accordance with these requirements, the nominee is deemed to have received a QN because the notice can be easily obtained from the National Association of Securities Dealers (NASD) or Securities Exchange on which the PTP is registered.

However, the requirements of 17 CFR 240.10b-17(b)(1) or (3) relate solely to the manner in which the notice must be issued by the PTP in order to qualify as a QN. Section 1.1446-4(d) indicates that a nominee is treated as a withholding agent for purposes of Section 1446 “only to the extent of the amount specified” in the QN. The special rules applicable to PTP distributions under Section 1.1445-8(a) similarly state that a nominee’s obligation to withhold tax on PTP distributions is imposed upon the nominee only to the extent of the amount specified by the QN.⁸ None of these provisions specifically indicates whether the notice must specify the source, character, amount, or other details of the distribution.

The responsibility for withholding under Section 1446 shifts to the nominee, however, only if the nominee receives a PTP distribution that is subject to withholding

⁶ Treas. Reg. §1.1446-4(d).

⁷ Treas. Reg. §1.1446-4(b)(4).

⁸ Treas. Reg. §1.1445-8(a)(3)(iv). Section 1445 imposes withholding obligations similar to those under Section 1446 with respect to distributions attributable to the disposition of a U.S. real property interest received by a nominee directly from a PTP. However, where the withholding requirements of Section 1446 are satisfied, the requirements of section 1445 are generally deemed to have been met. Treas. Reg. §1.1446-4(f)(4).

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under Section 1446. Section 1446 subjects only distributions of ECI to withholding.⁹ It is, therefore, not clear whether the nominee will be considered to have received a distribution on which it is required to withhold under Section 1446 if the QN does not explicitly confirm that the distribution includes an amount of ECI. Many notices issued by PTPs do not indicate the amount of ECI, if any, included in the distribution, or provide information regarding the character, source, or other details of the distribution. In those instances, it is not clear whether the nominee should treat the entire distributed amount as ECI or non-ECI or apply a different characterization analysis. Absent guidance on this point, it is not clear in such an instance whether the nominee has received a PTP distribution subject to withholding under Section 1446.

When the QN does not specify whether ECI has been distributed or the amount of ECI distributed, it is, therefore, not clear what withholding obligations, if any, apply to a custodian acting as a nominee. Section 1.1446-4(f)(3) provides ordering rules apparently designed to address this situation, at least for U.S. source amounts, but those rules apply by their literal terms only to the PTPs themselves. It is not clear whether they also apply to nominees. Where applicable, the ordering rules provide that PTP distributions are deemed to be paid out of the following types of income, in the order indicated:

1. Amounts attributable to income described in Section 1441 or 1442 that are not ECI, without regard to whether the amounts are subject to withholding because of a treaty or statutory exemption.¹⁰ Such a distribution is currently subject to withholding at a rate of 30 percent.¹¹
2. Amounts effectively connected with a U.S. trade or business, but not subject to withholding under Section 1446 (*e.g.*, as an amount exempt under an applicable treaty).¹² Such amounts presumably would remain subject to tax at an applicable treaty rate for a properly documented nonresident investor eligible for benefits under the treaty.
3. Amounts subject to withholding under Section 1446.¹³ Pursuant to Section 1446, such amounts are subject to withholding tax at the rate of 35 percent (or other applicable maximum statutory rate).

⁹ Treas. Reg. §1.1446-4(d).

¹⁰ Treas. Reg. §1.1446-4(f)(3)(i).

¹¹ Code §1441(a).

¹² Treas. Reg. §1.1446-4(f)(3)(ii).

¹³ Treas. Reg. §1.1446-4(f)(3)(iii).

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4. Amounts not listed in paragraphs (f)(3)(i) through (iii) of this section.¹⁴

Therefore, under current rules, and without confirmation regarding ordering rules to be applied by nominees in the absence of QN information regarding the distribution, it is conceivable that a nominee could determine that any of the following withholding regimes applies:

- No withholding, if the nominee is not considered to have received a PTP distribution of ECI subject to withholding under Section 1446 in the absence of an explicit statement to that effect, and if the nominee's withholding obligations are considered satisfied because Section 6031 reporting responsibilities have been met.
- Withholding under section 1441 or 1442, if the nominee is not considered to have received a PTP distribution of ECI subject to withholding under Section 1446 in the absence of an explicit statement to that effect, if the nominee is considered a withholding agent for purposes of Section 1441 or 1442, and if the amount distributed constitutes U.S. source FDAP.
- Withholding under section 1446, if the PTP notice is considered to qualify as a QN that causes the nominee to be considered to have received a PTP distribution of ECI subject to withholding under Section 1446, even if the notice does not specify that the distribution includes an amount of ECI.

Issues regarding the penalty protection of nominees

Section 1.1446-4(d) provides, in part, that a nominee that receives a distribution from a publicly traded partnership subject to withholding under Section 1446, which is to be paid to (or for the account of) any foreign person, may be treated as a withholding agent for purposes of Section 1446.¹⁵ A nominee is treated as a withholding agent under Section 1446, however, only to the extent of the amount specified in the qualified notice received by the nominee. Thus, it appears that a nominee should be protected from penalties for underreporting with respect to the amount specified in the QN, as the nominee's responsibility to withhold is based in part on the information available from the QN issued by the PTP.

It is not entirely clear, however, whether the nominee could be subject to penalties for underreporting if the information contained in the QN was incorrect or

¹⁴ Treas. Reg. §1.1446-4(f)(3)(iv).

¹⁵ Treas. Reg. §1.1446-4(d).

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insufficient for the determination of the appropriate rate of withholding. Guidance should be issued to clarify that the nominee is not subject to penalties for underreporting in such instances.

Request for clarification and guidance

The AGC respectfully requests that the Service and Treasury provide clarification as soon as possible regarding the tax withholding and reporting obligations of a custodian acting as a U.S. or foreign nominee with respect to PTP distributions to foreign partners. We would ask that these issues be added to the 2009-2010 Priority Guidance Plan at its next periodic update and that guidance, including temporary interim guidance if appropriate, be issued as quickly as possible.

In particular, the AGC requests that guidance be issued to provide clarification regarding the following issues:

1. Is a custodian acting as nominee obligated to withhold tax under Section 1446 even when the QN issued by the PTP does not confirm that all of the requirements of Section 1.1446-4(d) are met, including the distribution of an amount of ECI? Specifically, must a custodian acting as nominee consider any notice of a PTP distribution that is issued in the manner specified by 17 CFR 240.10b-17(b)(1) or (3) to constitute a QN that imposes a withholding obligation on it, without regard to the content of the notice?
2. To the extent that notice of a PTP distribution does not indicate the amount of ECI distributed, or provide other information regarding the character and source of the distribution, how should the nominee determine the character of the distribution and whether it should be treated as ECI in full, non-ECI in full, or in another manner?
3. To the extent that the PTP identifies only the ECI portion of a distribution, how should the nominee determine the source and character of the balance of the amount distributed for purposes of ascertaining whether it is subject to other withholding and reporting obligations?
4. What withholding and reporting obligations, if any, apply to custodians acting as nominees in connection with distributions from non-U.S. PTPs?
5. Is it correct to conclude that a custodian acting as nominee may not be subjected to penalties for underreporting if the information contained in the QN was incorrect or was insufficient for the determination of the appropriate rate of withholding?

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6. To what extent, if any, does the analysis of these issues depend on whether the custodian has followed the Section 6031 nominee reporting process?

These regulatory gaps lead to uncertainty for custodians and investors, potential withholding tax exposure for custodians, and potential over-withholding on distributions from publicly traded partnerships. The issuance of the requested guidance would resolve significant issues relevant to custodians generally, promote sound tax administration, enable custodians and the Service to administer the law uniformly and efficiently, and reduce potential controversy.

Given the limitations and ambiguities of currently available guidance, the AGC requests that new guidance issued confirm the acceptability of reasonable positions taken by custodians during past periods, even if those positions are not fully consistent with the newly issued guidance.

* * * *