Bloomberg Tax

Daily Tax Report®

INSIGHT: Treasury, IRS Propose Regulations Implementing Source-of-Income Rules for Foreign Person's Disposition of Domestic Partnership Interest

BY BRIAN GAUDET

Statutory changes made to the federal tax laws by Congress at the end of 2017, unofficially referred to as the Tax Cuts and Jobs Act (''TCJA''), included new tax code Section 864(c)(8). Tax code Section 864(c)(8) provides that gain or loss realized from the sale, exchange, or other disposition (each a ''transfer'') of a partnership interest by a nonresident alien individual or foreign corporation (each a ''foreign transferor'') is effectively connected with the foreign transferor's conduct of a trade or business within the U.S. (a ''USTB''), but only to the extent the partnership's effectively connected gain or loss would have been allocated to the foreign transferor if the partnership had sold all of its assets at fair market value as of the date of the foreign transferor's transfer of its partnership interest (the ''deemed sale''). (Tax code Section 864(c)(8)(A) and (B).) Subject to this limitation, a foreign transferor's gain from the transfer of its interest in a partnership that is partly or wholly engaged in the conduct of a USTB will be subject to federal income tax.

Tax code Section 864(c)(8) is effective for sales, exchanges, and dispositions occurring on or after Nov. 27, 2017. (TCJA Section 13501(c)(1).) Tax code Section 864(c)(8) directs the Secretary of the Treasury to prescribe such regulations or other guidance as the Secretary determines appropriate. (Tax code Section 864(c)(8)(E).)

The U.S. Department of the Treasury and the Internal Revenue Service have proposed regulations implementing new tax code Section 864(c)(8). (Gain or Loss of Foreign Persons From Sale or Exchange of Certain Partnership Interests (hereinafter ''REG–113604–18''), 83 Fed. Reg. 66,647–66,655 (Dec. 27, 2018) (to be codified at 26 C.F.R. pt. 1).) The IRS's *Summary* of the proposed Treasury regulations provides:

''The proposed regulations affect certain foreign persons that recognize gain or loss from the sale or exchange of an interest in a partnership that is engaged in a trade or business within the United States. The proposed regulations also affect partnerships that directly or indirectly have one or more foreign persons as partners.'' (Preamble to REG–113604–18, 83 Fed. Reg. 66,647.) A 'partnership' includes any eligible business entity that is subject to federal income taxation as a partnership pursuant to Treasury Regulation Section 301.7701-3 (as amended by T.D. 9300, 2007-2 I.R.B. 246).

Background

A foreign partner in a partnership that is engaged in the conduct of a USTB is itself treated as being engaged in the conduct of a USTB and is subject to federal income tax on its allocated share of partnership income. (Tax code Section 875(1).) Further, the IRS ruled in 1991 that gain realized by a foreign partner from the sale or exchange of an interest in a partnership engaged in a USTB was effectively connected income subject to federal income tax. (Revenue Ruling 91-32.) Generally, a foreign partner would determine the extent to which its gain from the sale of its partnership interest was subject to federal income tax with respect to the partnership's property located in the U.S. and used (or held for use) in its USTB. In the summer of 2017, however, the U.S. Tax Court issued its opinion in *Grecian Magnesite Mining v. Commissioner*, which overturned IRS's policy of taxing a foreign partner on the gain realized from a sale or exchange of an interest in a partnership engaged in a USTB. (149 T.C. 63, 92 (gain realized from the redemption of LLC membership interests by a foreign corporation is not U.S.-source income)). Subsequently, Congress overturned the Tax Court, enacting new tax code Section 864(c)(8), which became law at the end of 2017. At the same time, Congress and the President enacted new tax code Section 1446(f) to impose a withholding requirement on the transferee of a foreign transferor's partnership interest or, in default of the transferee's obligations, on the partnership itself. (TCJA Section 13501(b).)

New Tax Code Section 1446(f)

New tax code Section 1446(f) requires that if any portion of the gain on transfer of a partnership interest would be treated as effectively connected with the conduct of a USTB under new tax code Section 864(c)(8), then the transferee of the partnership interest must deduct and withhold 10 percent of the amount realized (generally, the transferee's purchase price) unless the transferor certifies that it is not a foreign person. (Tax code Section 1446(f)(1), (2)(A).) If a transferee that has

a withholding obligation fails to withhold the required amount, the partnership is required to deduct and withhold from distributions to the transferee an amount of tax equal to the amount the transferee failed to withhold, plus interest. (Tax code Section 1446(f)(4).) New tax code Section 1446(f) is effective for sales, exchanges, and dispositions occurring after Dec. 31, 2017. (TCJA Section 13501(c)(2).) Tax code Section 1446(f)(6) specifically authorizes the Secretary of the Treasury to prescribe such regulations or other guidance as may be necessary to carry out the purposes of the subsection (f) withholding requirement, including regulations providing for exceptions from the withholding requirement, and tax code Section 1446(g) generally authorizes the Secretary of the Treasury to prescribe such regulations as may be necessary to carry out the purposes of tax code Section 1446.

Interim Guidance

On Dec. 29, 2017, Treasury and the IRS released Notice 2018-08 (the ''PTP Notice''). The PTP Notice temporarily suspends the requirement to withhold on amounts realized in connection with the sale, exchange, or disposition of certain interests in publicly traded partnerships. Further, on April 2, 2018, Treasury and the IRS released Notice 2018-29, publishing interim guidance on reporting and paying over the required withholding amount and announcing their intent to issue proposed regulations under tax code Section 1446(f) that apply in the case of any disposition of a partnership interest that is not publicly traded. In addition to implementing the Section 1446(f)(2) exception for non-foreign transferors, Notice 2018-29 provided that if a transferee received a certification from a transferor that the transfer will not result in gain, then the transferee generally was not required to withhold under new tax code Section 1446(f). Notice 2018-29 also provided that if a transferor certified to a transferee that for each of the past three years the transferor's effectively connected taxable income from the partnership was less than 25 percent of the transferor's total income from the partnership, the withholding requirement did not apply. Separately, Notice 2018-29 relieved a transferee of its withholding obligation if the partnership certified to the transferee that the partnership's effectively connected gain under new tax code Section 864(c)(8) would be less than 25 percent of its total gain on the deemed sale of its assets.

The Proposed Regulations Under New Tax Code Section 864(c)(8)

The proposed regulations implement new tax code Section 864(c)(8) only. (Preamble to REG-113604-18, 83 Fed. Reg. 66,647 (*Summary*).) The proposed regulations do not provide guidance under new tax code Section 1446(f). (Preamble to REG-113604-18, 83 Fed. Reg. 66,647, 66,650 (*VI. Section 1446(f) Guidance*).) Treasury and the IRS intend to issue guidance under new tax code Section 1446(f) expeditiously. In the interim, please refer to Notices 2018-08 and 2018-29 regarding withholding obligations imposed on a transferee of a partnership interest received from a foreign transferor and the partnership in which such foreign transferor transferred an interest. (IRS Notice 2018-29, Section 1.)

Determining a Foreign Partner's Gain or Loss on the Transfer of a Partnership Interest

New tax code Section 864(c)(8) provides that gain or loss of a foreign transferor from the transfer of an interest, owned directly or indirectly, in a partnership that is engaged in any USTB is treated as effectively connected gain or loss to the extent such gain or loss does not exceed the portion of the foreign transferor's distributive share of gain or loss that would have been effectively connected gain or loss if the partnership had sold all of its assets at fair market value. (Tax code Section 864(c)(8)(A).) The proposed regulations provide rules for determining such gain or loss. (Preamble to REG-113604-18, 83 Fed. Reg. 66,647, 66,647–48 (*I. Gain or Loss on the Transfer of a Partnership Interest*).)

General Rules

The proposed regulations require that a foreign transferor first determine its gain or loss on the transfer of a partnership interest (''outside gain'' and ''outside loss''). (Preamble to REG-113604-18, 83 Fed. Reg. 66,647, 66,648 (*I.A. Determination of Gain or Loss Described in Section 864(c)(8)(A)*).) The amount and character of a foreign transferor's outside gain and outside loss on the transfer of a partnership interest is determined under all relevant provisions of the tax code and the regulations. For example, the tax code and regulations generally provide that a reduction in a partner's share of partnership liabilities is treated as an amount realized on the transfer of a partnership interest. (Preamble to REG-113604-18, 83 Fed. Reg. 66,647, 66,648 (*I.A.1. Interaction With Sections 741 and 751*).) Further, the tax code provides that gain or loss on a sale or exchange of an interest in a partnership is recognized by the transferor as capital gain or loss, except as otherwise provided in the tax code (e.g., the portion of the gain or loss attributable to the partnership's unrealized receivables or inventory items is considered ordinary income or loss). As a result, outside gain or outside loss on a sale or exchange of a partnership interest can be comprised of capital gain, capital loss, ordinary income, or ordinary loss (or a combination thereof) (i.e., ''outside capital gain'' or ''outside capital loss'' and ''outside ordinary gain'' or ''outside ordinary loss''). The proposed regulations provide that a foreign transferor must determine the portion of its capital gain or loss and ordinary income or loss that must each be characterized as effectively connected gain or loss under tax code Section 864(c)(8).

Nonrecognition Transactions

New tax code Section 864(c)(8) authorizes regulations or other guidance with respect to its application to corporate nonrecognition transactions under subchapter C of chapter 1 of the tax code. (Tax code Section 864(c)(8)(E), referencing tax code Sections 332, 351, 354, 355, 356, or 361.) The proposed regulations provide that the gain or loss on the transfer of a partnership interest that is subject to tax as effectively connected gain or loss is limited to gain or loss otherwise recognized under the tax code. (Proposed Treas. Reg. Section 1.864(c)(8)-1(b)(2)(ii).) When a nonrecognition

provision results in a foreign transferor recognizing only a portion of its gain or loss on the transfer of an interest in a partnership, new tax code Section 864(c)(8) may apply with respect to the portion of the gain or loss recognized. However, the proposed regulations do not contain special rules applicable to nonrecognition transactions. (Preamble to REG-113604-18, 83 Fed. Reg. 66,647, 66,648 (*I.A.2. Nonrecognition Transactions*).) Treasury and the IRS recognize that certain nonrecognition transactions, such as a distribution of partnership property to a foreign partner, may have the effect of reducing gain or loss that would be taken into account for federal income tax purposes. For example, if a partnership that conducts a USTB owns property that would not be effectively connected to a USTB in the hands of its foreign partner, a partnership might distribute that property to a foreign partner instead of to a U.S. partner. Treasury and the IRS continue to consider and are soliciting comments regarding whether other tax code provisions adequately address such transactions and may propose rules addressing these types of transactions.

Surprisingly, however, the proposed regulations do not address obvious planning strategies that may permit a foreign owner of a U.S.-domestic LLC that files tax returns with respect to its USTB as a partnership to avoid the imposition of U.S. income tax on a sale, exchange or other disposition of its membership interests in such LLC. Tax code Section 864(c)(8) is broad in scope, applying to ''any sale, exchange or other disposition,'' and Congress granted specific statutory authority to the Secretary of the Treasury to ''prescribe such regulations and other guidance as the Secretary determines appropriate for the application of [paragraph (8)], including with respect to exchanges described in section 332, 351, 354, 356, or 361.'' *See* tax code Section 864(c)(8)(D) and (E). However, under the rules, as proposed, such an LLC could, for adequate business purposes, convert itself into a state law taxable corporation in a nonrecognition transaction in which all the members of the LLC would exchange their interests in the LLC for proportionate amounts of stock in the resulting corporation.

The proposed regulations appear not to impose federal income tax on gain realized by a selling foreign equity owner that is not recognized under tax code Section 351 at the time of the conversion transaction or, later, when the foreign equity owner subsequently sells its shares of stock in the resulting corporation in a transaction that otherwise does not generate U.S. source income, as discussed below. (Tax code Section 865(a)(2), (g). *See also* the discussion, below, regarding the non-exclusivity of tax code Section 864(c)(8).) As a result, foreign owners of equity interests in tax-transparent U.S.-domestic LLCs that convert into a taxable corporation may completely avoid the new sourcing rule of tax code Section 864(c)(8) and any U.S. income tax resulting from the exchange of membership interests in the converted LLC for stock of the corporation, or upon any subsequent disposition of the stock.

Determining the Foreign Partner's Effectively Connected Income Limitation

As noted above, new tax code Section 864(c)(8) limits the amount of a foreign transferor's taxable gain or loss to the portion of the foreign transferor's distributive share of gain or loss that would have been effectively connected gain or loss if the partnership had sold all of its assets at fair market value. Certainly, if a partnership's trade or business is conducted wholly within the U.S., then all of the foreign transferor's outside gain or loss could be taxable in the U.S. as effectively connected gain or loss. This assumes, among other things, that (i) all of the partnership's assets generate income that is effectively connected with the LLC's USTB, which may not be the case, (ii) gain realized in an exempt nonrecognition exchange is not partially taxable, as discussed, *supra*, (iii) the exceptions provided in Prop. Treas. Reg. Section 1.864(c)(8)-1(c)(2)(ii), discussed *infra*, do not apply, and (iv) U.S.-source gain is not recognized under the ''gains'' article of an in-force income tax treaty between the foreign transferor's country of residence and the U.S., as discussed below. However, if a partnership conducts its trade or business both within and without the U.S., a foreign transferor must determine the extent to which the limitation for effectively connected income applies.

A foreign transferor of a partnership interest that conducts its trade or business within and without the U.S. and wants to avail itself of the effectively connected income limitation must determine three amounts: (1) the gain or loss that the partnership would recognize in connection with a deemed sale of each separate asset for fair market value, (2) the amount of such deemed gain or loss that would be treated as effectively connected gain or loss (i.e., ''deemed sale EC gain'' and ''deemed sale EC loss''), and (3) the foreign transferor's distributive share of the capital and ordinary components of any deemed sale EC gain and deemed sale EC loss. The separate sums of these components for all assets are referred to as the foreign transferor's ''aggregate deemed sale EC capital gain,'' ''aggregate deemed sale EC capital loss,'' ''aggregate deemed sale EC ordinary gain,'' and ''aggregate deemed sale EC ordinary loss.'' (Preamble to REG-113604-18, 83 Fed. Reg. 66,647, 66,648 (*I.B.1. Determination of Deemed Sale Gain or Loss – In General*).)

To implement the effectively connected income limitation, a foreign transferor must generally compare each outside gain or loss with the relevant aggregate deemed sale EC gain or loss, made separately with respect to each capital gain or capital loss and gain treated as ordinary income and ordinary loss. Thus, for example, a foreign transferor would compare its outside capital gain to its aggregate deemed sale EC capital gain, treating its outside capital gain as effectively connected gain only to the extent such outside capital gain does not exceed such aggregate deemed sale EC capital gain.

To prevent converting gain or loss from assets with no connection to the partnership's USTB into effectively connected gain or loss, the proposed regulations provide that gain or loss from the deemed sale of a partnership asset is not treated as effectively connected gain or loss if (1) no income or gain previously produced by the asset was taxable as effectively connected with the conduct of a USTB by the partnership (or a predecessor of the partnership) during the ten-year period ending on the date of the transfer, and (2) the asset was not used, or held for use, in the conduct of a USTB by the partnership (or a predecessor of the partnership) during the ten-year period ending on the date of trans-

fer. (Preamble to REG-113604-18, 83 Fed. Reg. 66,647, 66,648-49 (*I.B.2. Treatment of Deemed Sale Gain or Loss as Effectively Connected Gain or Loss*).)

Comments are requested as to whether additional guidance is needed regarding the source of gain or loss resulting from a deemed sale by the partnership, including rules coordinating this rule with the exception applicable to a foreign person that maintains an office or other fixed place of business in the U.S. with respect to a sale of inventory property which is sold for use, disposition, or consumption outside the U.S. through the taxpayer's office or other fixed place of business in a foreign country that materially participated in the sale.

Determining the Foreign Partner's Distributive Share of the Partnership's Deemed Effectively Connected Gain and Loss

New tax code Section 864(c)(8) provides that a foreign transferor's distributive share of gain or loss on the deemed sale of partnership property is determined in the same manner as the transferor partner's distributive share of the non-separately stated taxable income or loss of the partnership. (Preamble to REG-113604-18, 83 Fed. Reg. 66,647, 66,649 (*I.B.3. Determining Distributive Share of Deemed Sale EC Gain and Deemed Sale EC Loss*).) The term ''non-separately stated taxable income or loss of the partnership'' is not defined in the tax code or regulations. The proposed regulations provide that a partner's distributive share of gain or loss from the deemed sale is determined under all applicable tax code sections, including all partnership provisions governing the determination of a partner's distributive share of income, deduction, gain, loss and credit.

However, Treasury and the IRS are considering whether these rules adequately prevent the avoidance of the purposes of new tax code Section 864(c)(8) through allocations of effectively connected gain or loss made to specific partners. For example, immediately before a foreign transferor sells its interest in a partnership, adjustments could be made to partnership allocations that would result in the foreign transferor recognizing less effectively connected gain from the deemed sale by the partnership. Although statutory and regulatory provisions, as well as judicial doctrines, may limit the extent to which inappropriate results may be obtained in that transaction or similar transactions, Treasury and the IRS are considering whether additional guidance is necessary to prevent abuse. Comments are requested as to whether there are specific situations in which the purposes of new tax code Section 864(c)(8) may be avoided, and for specific suggestions for additional guidance to address those situations.

New Tax Code Section 864(c)(8) is Non-Exclusive

The proposed regulations do not apply to prevent any portion of gain or loss recognized on the transfer of a partnership interest from being treated as effectively connected gain or loss under other provisions of the tax code (subject to a special rule, discussed below, coordinating the application of new tax code Sections 864(c)(8) and 897 relating to federal income tax imposed on the disposition of an interest in U.S. real property). (Preamble to REG-113604-18, 83 Fed. Reg. 66,647, 66,649 (***I.D. Provision Is Non-Exclusive)***.) Thus, if a foreign transferor maintains an office or fixed place of business in the U.S. and sells a partnership interest in a transaction that generates gain or loss attributable to that office, gain or loss recognized in connection with that transfer may be U.S. source income and may be treated as effectively connected income under other statutory rules that address circumstances in which periodical income and capital gain may be effectively connected with the conduct of a USTB. If the amount of gain or loss recognized by a foreign transferor that would be treated as effectively connected gain or loss under such other tax code sections exceeds the amount of gain that would be treated as effectively connected gain under new tax code Section 864(c)(8), then the larger amount would be treated as effectively connected gain.

Coordination With Tax Code Section 897

Similar to the result provided by tax code Section 864(c)(8) with respect to gain or loss realized by a foreign transferor from the transfer of an equity interest in a partnership engaged in a USTB, tax code Section 897 generally provides that a nonresident alien individual and a foreign corporation is subject to federal income tax on gain or loss from the disposition of a U.S. real property interest. (Tax code Section 897(a)(1).) Further, tax code Section 897(g) provides, under regulations prescribed by the Secretary of the Treasury, that the amount realized by such a transferor in exchange for all or part of its interest in the partnership is, to the extent attributable to U.S. real property interests, considered as an amount received from the sale or exchange of such property.

In general, new tax code Section 864(c)(8)(C) provides that if a partnership engaged in a USTB holds any U.S. real property interest at the time a foreign transferor transfers its interest in the partnership, then the amount of effectively connected gain or loss under new tax code Section 864(c)(8) is reduced by the amount of effectively connected gain or loss with respect to U.S. real property interests under tax code Section 897. This rule prevents effectively connected gain or loss from a U.S. real property interest that is taxed under tax code Section 897 from being taken into account a second time under tax code Section 864(c)(8). (REG-113604-18, 83 Fed. Reg. 66,647, 66,649-50 (*II. Coordination with Section 897*).)

The proposed regulations provide that when a partnership holds U.S. real property interests and is also subject to tax code Section 864(c)(8) because it is engaged in the conduct of a USTB without regard to tax code Section 897, the amount of the foreign transferor's effectively connected gain or loss will be determined under new tax code Section 864(c)(8) and not under tax code Section 897.

Application of New Tax Code Section 864(c)(8) to Tiered Partnerships

Tax code Section 864(c)(8) applies to a foreign nonresident alien individual or foreign corporation that di-

rectly *or indirectly* owns an interest in a partnership. The proposed regulations provide that if a foreign transferor transfers an interest in an upper-tier partnership that directly or indirectly owns an interest in one or more lower-tier partnerships that are engaged in the conduct of a USTB, then the taxpayer must determine (1) deemed gain or loss with respect to each lower-tier partnership, (2) the amount of effectively connected gain or loss that would be allocated to the upper-tier partnership by each lower-tier partnership, and (3) the amount of gain or loss recognized by the taxpayer that is treated as effectively connected gain or loss with reference to the taxpayer's distributive share of effectively connected gain or loss arising from each lower-tier partnership. (Preamble to REG-113604-18, 83 Fed. Reg. 66,647, 66,649-50 (*III. Tiered Partnerships*).)

The proposed regulations also clarify that when a foreign transferor is a partner in an upper-tier partnership and the upper-tier partnership transfers an interest in a lower-tier partnership that is engaged in the conduct of a USTB, the upper-tier partnership must determine its effectively connected gain or loss by applying the principles of the proposed regulations, including the tiered partnership rules described therein.

The Effect of Income Tax Treaties

The applicable ''gains'' articles of many U.S. income tax treaties allow the country in which a permanent establishment is located to tax gains from the alienation of movable property forming part of the business property of a permanent establishment, including gains from the alienation of a permanent establishment itself, alone or with the whole enterprise of which it is a part. Further, the permanent establishment of a partnership in the U.S. generally is considered a permanent establishment of the partners of the partnership, including the foreign partners. (Preamble to REG-113604-18, 83 Fed. Reg. 66,647, 66,649-50 (*IV. Treaties*).)

The proposed regulations provide that the transfer of a foreign partner's interest in a partnership, in whole or in part, is a transfer of all or part of a partner's permanent establishment. Thus, to the extent the partnership's assets form part of a foreign partner's permanent establishment within the U.S., the permanent establishment paragraph of the ''gains'' article would generally preserve the United States' taxing jurisdiction over the gain on the transfer of a partnership interest that otherwise is subject to tax under tax code Section 864(c)(8). (Prop. Treas. Reg. Section 1.864(c)(8)-1(f)(2).) In addition, if an income tax treaty has a ''gains'' article that permits the U.S. to apply its domestic laws to tax gains, or does not have a ''gains'' article, the treaty does not prevent the application of tax code Section 864(c)(8). (Tax code Section 7852(d)(1).)

''Gains'' articles of treaties frequently have special provisions covering certain assets, regardless of whether the assets form part of a permanent establishment, such as gains from dispositions of U.S. real property interests and ships and aircraft used in international traffic. (Preamble to REG-113604-18, 83 Fed. Reg. 66,647, 66,650 (*IV. Treaties*). *See, e.g.*, United States Model Income Tax Convention, February 17, 2016, Art. 13, paras. 1. and 2.b. and para 4.) If a ''gains'' article of an income tax treaty prohibits taxation of gain realized from the disposition of certain property, such as ships or aircraft used in international traffic, the proposed regulations provide that gains and losses from those assets will not be considered assets that form part of the permanent establishment, nor will they be taken into account in determining deemed sale EC gain or deemed sale EC loss for purposes of computing the limitation on the amount of gain or loss recognized pursuant to the treaty. (REG-113604-18, 83 Fed. Reg. 66,647, 66,650 (***IV. Treaties***); Prop. Treas. Reg. Section 1.864(c)(8)-1(f)(3).)

Further, if the ''gains'' article of an applicable income tax treaty allows the taxation of gain from the disposition of a U.S. real property interest, the transfer of an interest in a partnership that holds a U.S. real property interest remains subject to taxation under tax code Section 897(g) even if the transfer is not subject to tax code Section 864(c)(8) (because, e.g., the partnership's assets are not treated as forming part of a permanent establishment in the U.S.). (REG-113604-18, 83 Fed. Reg. 66,647, 66,650 (*IV. Treaties*), *citing* Prop. Treas. Reg. Section 1.864(c)(8)-1(d).)

Possibility of Double Taxation

Foreign owners of equity interests in U.S.-domestic entities that the U.S. treats as tax-transparent entities are at risk of incurring double taxation without the ability to obtain relief, for example, under the ''relief-from-double-taxation'' article of an applicable income tax treaty. Many LLCs that operate an effectively connected USTB enjoy tax-transparent status for U.S. income tax purposes by reason of their default tax classification under the entity classification rules set forth in Treas. Reg. Section 301.7701-3(b)(1)(i), filing U.S. tax returns as partnerships. However, a foreign owner's country of residence may not recognize the tax-transparent status of such LLCs for its own domestic income tax purposes. Accordingly, when a foreign owner transfers shares in a U.S.-domestic tax-transparent LLC and becomes subject to U.S. income tax by operation of tax code Section 864(c)(8), the foreign transferor's country of residence may take the position that gain realized by the foreign transferor from the sale of its interest in such LLC properly should be treated as gain from the sale of personal property not forming part of the business property of the LLC's permanent establishment under an applicable treaty (or, in the absence of an applicable treaty, an effectively connected USTB under the Code)—i.e., the foreign transferor is treated by its country of residence as disposing of shares in a non-tax-transparent business entity.

As a consequence, the foreign transferor's country of residence could source the foreign transferor's gain to itself, in accordance with rules applicable to sales of other personal property, either pursuant its tax treaty with the U.S., or in accordance with its generally applicable tax laws, and, as a result of the disparate treatment accorded to the transaction by the U.S., on the one hand, and by the foreign transferor's country of residence, on the other hand, a tax credit (or other favorable adjustment) for the taxes assessed by the U.S. on the same transaction (under either the ''gains'' article of the treaty or, if there is no applicable ''gains'' article, under tax code Section 864(c)(8)) may be disallowed to the foreign transferor. In that case, the foreign transferor's only option may be to seek relief from the competent authority under the ''mutual relief procedure'' of an

applicable treaty or, if no treaty is in force, to appeal any adverse ruling issued by its country of residence.

Effective Date of the Proposed Regulations

The proposed regulations apply to transfers occurring on or after Nov. 27, 2017, the effective date of new tax code Section 864(c)(8).

This column does not necessarily reflect the opinion of The Bureau of National Affairs, Inc. or its owners.

Brian Gaudet is counsel at Arent Fox LLP in the Boston office. He is a seasoned business lawyer advising public and private companies, handling domestic and international transactional tax work for buyers, sellers and investors, creating tax-optimal legal entity structures and day-to-day transaction flows for simple to complex businesses.