

Form W-8EXP) shall include the acceptable substitute form recognized under this paragraph (c)(5).

[T.D. 9200, 70 FR 28717, May 18, 2005, as amended by T.D. 9394, 73 FR 23074, Apr. 29, 2008]

**§ 1.1446-2 Determining a partnership's effectively connected taxable income allocable to foreign partners under section 704.**

(a) *In general.* A partnership's effectively connected taxable income (ECTI) is generally the partnership's taxable income as computed under section 703, with adjustments as provided in section 1446(c) and this section, and computed with consideration of only those partnership items which are effectively connected (or treated as effectively connected) with the conduct of a trade or business in the United States. For purposes of determining the section 1446 withholding tax (1446 tax) or any installment of such tax under § 1.1446-3, partnership ECTI allocable under section 704 to foreign partners is the sum of the allocable shares of ECTI of each of the partnership's foreign partners as determined under paragraph (b) of this section. See § 1.1446-6 (special rules permitting the partnership to consider partner-level deductions and losses to reduce the partnership's 1446 tax). The calculation of partnership ECTI allocable to foreign partners as set forth in paragraph (b) of this section and the partnership's withholding tax obligation are partnership-level computations solely for purposes of determining the 1446 tax. Therefore, any deduction that is not taken into account in calculating a partner's allocable share of partnership ECTI (e.g., percentage depletion), but which is a deduction that under U.S. tax law the foreign partner is otherwise entitled to claim, can still be claimed by the foreign partner when computing its U.S. tax liability and filing its U.S. income tax return, subject to any restriction or limitation that otherwise may apply.

(b) *Computation*—(1) *In general.* A foreign partner's allocable share of partnership ECTI for the partnership's taxable year that is allocable under section 704 to a particular foreign partner is equal to that foreign partner's dis-

tributive share of partnership gross income and gain for the partnership's taxable year that is effectively connected and properly allocable to the partner under section 704 and the regulations thereunder, reduced by the foreign partner's distributive share of partnership deductions for the partnership taxable year that are connected with such income under section 873(a) or 882(c) and properly allocable to the partner under section 704 and the regulations thereunder, in each case, after application of the rules of this section. See § 1.1446-6 (special rules permitting the partnership to consider partner-level deductions and losses to reduce the partnership's 1446 tax). For these purposes, a foreign partner's distributive share of effectively connected gross income and gain and the deductions connected with such income shall be computed by considering allocations that are respected under the rules of section 704 and § 1.704-1(b)(1), including special allocations in the partnership agreement (as defined in § 1.704-1(b)(2)(ii)(h)), and adjustments to the basis of partnership property described in section 743 pursuant to an election by the partnership under section 754 (see § 1.743-1(j)). The character of effectively connected partnership items (capital versus ordinary) shall be separately considered only to the extent set forth in paragraph (b)(3)(v) of this section and, when applicable, sections 1.1446-3(a)(2) (consideration of preferential rates when computing 1446 tax) and section 1.1446-6 (special rules permitting the partnership to consider partner-level deductions and losses to reduce the partnership's 1446 tax).

(2) *Income and gain rules.* For purposes of computing a foreign partner's allocable share of partnership ECTI under this paragraph (b), the following rules shall apply with respect to partnership income and gain.

(i) *Application of the principles of section 864.* The determination of whether a partnership's items of gross income are effectively connected shall be made by applying the principles of section 864 and the regulations thereunder.

(ii) *Income treated as effectively connected.* A partnership's items of gross income that are effectively connected include any income that is treated as

effectively connected income, including partnership income subject to a partner's election under section 871(d) or section 882(d), any partnership income treated as effectively connected with the conduct of a U.S. trade or business pursuant to section 897, and any other items of partnership income treated as effectively connected under another provision of the Internal Revenue Code, without regard to whether those amounts are taxable to the partner. A partner that makes the election under section 871(d) or section 882(d) shall furnish to the partnership a statement that indicates that such election has been made. See § 1.871-10(d)(3). If a partnership receives a valid Form W-8ECI from a partner, the partner is deemed, for purposes of section 1446, to have effectively connected income subject to withholding under section 1446 to the extent of the items identified on the form.

(iii) *Exempt income.* A foreign partner's allocable share of partnership ECTI does not include income or gain exempt from U.S. tax by reason of a provision of the Internal Revenue Code. A foreign partner's allocable share of partnership ECTI also does not include income or gain exempt from U.S. tax by operation of any U.S. income tax treaty or reciprocal agreement. In the case of income excluded by reason of a treaty provision, such income must be derived by a resident of an applicable treaty jurisdiction, the resident must be the beneficial owner of the item, and all other requirements for benefits under the treaty must be satisfied. The partnership must have received from the partner a valid withholding certificate, that is, Form W-8BEN (see § 1.1446-1(c)(2)(iii) regarding when a Form W-8BEN is valid for purposes of this section), containing the information necessary to support the claim for treaty benefits required in the forms and instructions. In addition, for purposes of this section, the withholding certificate must contain the beneficial owner's taxpayer identification number.

(3) *Deductions and losses.* For purposes of computing a foreign partner's allocable share of partnership ECTI under this paragraph (b), the following rules

shall apply with respect to deductions and losses.

(i) *Oil and gas interests.* The deduction for depletion with respect to oil and gas wells shall be allowed, but the amount of such deduction shall be determined without regard to sections 613 and 613A.

(ii) *Charitable contributions.* The deduction for charitable contributions provided in section 170 shall not be allowed.

(iii) *Net operating losses and other suspended or carried losses.* Except as provided in § 1.1446-6, the net operating loss deduction of any foreign partner provided in section 172 shall not be taken into account. Further, except as provided in § 1.1446-6, the partnership shall not take into account any suspended losses (e.g., losses in excess of a partner's basis in the partnership, see section 704(d)) or any capital loss carrybacks or carryovers available to a foreign partner.

(iv) *Interest deductions.* The rules of this paragraph (b)(3)(iv) shall apply for purposes of determining the amount of interest expense that is allocable to income which is (or is treated as) effectively connected with the conduct of a trade or business for purposes of calculating a foreign partner's allocable share of partnership ECTI. In the case of a non-corporate foreign partner, the rules of § 1.861-9T(e)(7) shall apply. In the case of a corporate foreign partner, the rules of § 1.882-5 shall apply by treating the partnership as a foreign corporation and using the partner's pro-rata share of the partnership's assets and liabilities for these purposes. For these purposes, the rules governing elections under § 1.882-5(a)(7) shall be made at the partnership level.

(v) *Limitation on capital losses.* Losses from the sale or exchange of capital assets allocable under section 704 to a partner shall be allowed only to the extent of gains from the sale or exchange of capital assets allocable under section 704 to such partner.

(vi) *Other deductions.* No deduction shall be allowed for personal exemptions provided in section 151 or the additional itemized deductions for individuals provided in part VII of subchapter B of the Internal Revenue Code (section 211 and following).

(vii) *Limitations on deductions.* Except as provided in §1.1446-6 and this paragraph (b)(3), any limitations on losses or deductions that apply at the partner level when determining ECTI allocable to a foreign partner shall not be taken into account.

(4) *Other rules—(i) Exclusion of items allocated to U.S. partners.* Except as provided in §1.1446-5(e), in computing partnership ECTI, the partnership shall not take into account any item of income, gain, loss, or deduction to the extent allocable to any partner that is not a foreign partner, as that term is defined in §1.1446-1(c).

(ii) *Partnership credits.* See §1.1446-3(a) providing that the 1446 tax is computed without regard to a partner's distributive share of the partnership's tax credits.

(5) *Examples.* The following examples illustrate the application of this section. In considering the examples, disregard the potential application of §1.1446-3(b)(2)(v)(F) (relating to the de minimis exception to paying 1446 tax). The examples are as follows:

*Example 1. Limitation on capital losses.* PRS partnership has two equal partners, A and B. A is a nonresident alien and B is a U.S. citizen. A provides PRS with a valid Form W-8BEN, and B provides PRS with a valid Form W-9. PRS has the following annualized tax items for the relevant installment period, all of which are effectively connected with its U.S. trade or business and are allocated equally between A and B: \$100 of long-term capital gain, \$400 of long-term capital loss, \$300 of ordinary income, and \$100 of ordinary deductions. Assume that these allocations are respected under section 704(b) and the regulations thereunder. Accordingly, A's allocable share of PRS's effectively connected items includes \$50 of long-term capital gain, \$200 of long-term capital loss, \$150 of ordinary income, and \$50 of ordinary deductions. In determining A's allocable share of partnership ECTI, the amount of the long-term capital loss that may be taken into account pursuant to paragraph (b)(3)(v) of this section is limited to A's allocable share of gain from the sale or exchange of capital assets. Accordingly, A's share of partnership ECTI allocable under section 704 pursuant to §1.1446-2 is \$100 (\$150 of ordinary income less \$50 of ordinary deductions, plus \$50 of capital gain less \$50 of capital loss).

*Example 2. Limitation on capital losses—special allocations.* PRS partnership has two equal partners, A and B. A and B are both nonresident aliens. A and B each provide PRS with a valid Form W-8BEN. PRS has

the following annualized tax items for the relevant installment period, all of which are effectively connected with its U.S. trade or business: \$200 of long-term capital gain, \$200 of long-term capital loss, and \$400 of ordinary income. A and B have equal shares in the ordinary income, however, pursuant to the partnership agreement, capital gains and losses are subject to special allocations. The long-term capital gain is allocable to A, and the long-term capital loss is allocable to B. Assume that these allocations are respected under section 704(b) and the regulations thereunder. Pursuant to paragraph (b)(3)(v) of this section, A's allocable share of partnership ECTI under §1.1446-2 is \$400 (consisting of \$200 of ordinary income and \$200 of long-term capital gain), and B's allocable share of partnership ECTI is \$200 (consisting of \$200 of ordinary income).

*Example 3. Withholding tax obligation where partner has net operating losses.* PRS partnership has two equal partners, FC, a foreign corporation, and DC, a domestic corporation. FC and DC provide a valid Form W-8BEN and Form W-9, respectively, to PRS. Both FC and PRS are on a calendar taxable year. PRS is engaged in the conduct of a trade or business in the United States and for its first installment period during its taxable year has \$100 of annualized ECTI that is allocable to FC. As of the beginning of the taxable year, FC had an unused effectively connected net operating loss carryover in the amount of \$300. FC's net operating loss carryover is not taken into account in determining FC's allocable share of partnership ECTI under §1.1446-2 and, absent the application of §1.1446-6 (permitting a foreign partner to certify deductions and losses reasonably expected to be available to reduce the partner's U.S. income tax liability on the effectively connected income or gain allocable from the partnership), is not considered in computing the 1446 tax installment payment due on behalf of FC. Accordingly, PRS must pay 1446 tax with respect to the \$100 of ECTI allocable to FC.

[T.D. 9200, 70 FR 28717, May 18, 2005, as amended by T.D. 9394, 73 FR 23074, Apr. 29, 2008]

### § 1.1446-3 Time and manner of calculating and paying over the 1446 tax.

(a) *In general—(1) Calculating 1446 tax.* This section provides rules for calculating, reporting, and paying over the section 1446 withholding tax (1446 tax). A partnership's 1446 tax equals the amount determined under this section and shall be paid in installments during the partnership's taxable year (see paragraph (d)(1) of this section for installment payment due dates), with