

## Secondary U.S. Withholding for Transfers in Private Investment Funds Delayed Until January 1, 2023

August 26, 2021

### Key Points

- Fund-level liability for a buyer's failure to withhold upon secondary market transfer of an LP interest in a fund with ECI assets will apply only for transfers on or after January 1, 2023.
- Certain additional delay has also been provided for transfers and distributions in the MLP space until 2023.

The U.S. Internal Revenue Service (IRS) has further delayed until January 1, 2023 the application of the secondary withholding liability that applies in case of secondary market transfers in private investment funds with underlying assets that give rise to income effectively connected with the conduct of a U.S. trade or business (ECI). Buyers of such partnership interests must generally withhold 10% of the gross proceeds paid to a non-U.S. seller, unless an exemption applies. If the buyer fails to adequately withhold then by statute the fund itself becomes secondarily liable vis-à-vis the IRS and must withhold the relevant amounts on distributions going forward to the buyer/transferee partner. This secondary withholding requirement had already been deferred once, and has now been pushed back further until January 1, 2023 ([Notice 2021-51](#)).

The 2017 U.S. Tax Cuts and Jobs Act (TCJA) codified a long-standing IRS position that certain non-U.S. persons who transfer an interest in an investment fund treated as a "partnership" for U.S. federal income tax purposes (e.g., a private fund, feeder or alternative investment vehicle that is structured as a Delaware limited partnership or limited liability company, or a Cayman Islands exempted limited partnership) must recognize gain to the extent any underlying assets give rise to ECI as if such non-U.S. persons had directly disposed of the assets (Section 864(c)(8) of the U.S. Internal Revenue Code). To backstop the substantive U.S. tax liability of such non-U.S. transferors, the transferee of the interest (which could potentially include a redeeming or distributing partnership) must generally withhold 10% of the amount realized on the transfer (which may include the transferor's allocable share of fund liabilities, in addition to any purchase price paid), irrespective of the materiality of underlying ECI

### Contact Information

If you need assistance or have questions regarding this alert, please contact your Akin Gump relationship attorney or one of the authors.

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assets relative to the entire asset pool of the fund or other relevant vehicle (Section 1446(f) of the U.S. Internal Revenue Code). Final U.S. Treasury regulations were adopted to govern the primary withholding responsibility among transferring parties in case of a secondary market transfer of interests in a private investment fund. Certain exemptions apply, such as for transfers where the transferor or the fund can certify that the fund or other relevant vehicle has “less than 10% ECI gain.”

Under the withholding statute, if a transferee fails to withhold then the fund itself becomes secondarily liable vis-à-vis the IRS and must withhold the relevant amounts on distributions made to the transferee partner (whether it is a U.S. person or non-U.S. person). This secondary withholding requirement has now been pushed back further until January 1, 2023.

Note that the requirement to withhold upon transfer should be distinguished from the issue whether the transferor (or, in case of a partnership-transferor, the direct or indirect partners in such transferor) of a partnership interest recognizes ECI gain and is therefore required to pay U.S. federal income tax and file U.S. federal income tax returns in respect of such gain (Section 864(c)(8)). Under the U.S. Tax Cuts and Jobs Act (TCJA), these substantive U.S. federal tax requirements generally apply for all transfers of partnership interests on or after November 27, 2017. Special rules apply for transfers or distributions in publicly traded partnerships or master limited partnerships (PTPs or MLPs).

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