

# Withholding Tax Liability Is a Partnership Item, Tax Court Rules

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A partnership's liability for withholding tax is a partnership item within the scope of Treasury regulations and may be addressed in partnership-level proceedings, according to the U.S. Tax Court.

The Tax Court rejected the partnership's argument on August 8 in [YA Global Investments v. Commissioner](#) that [section 1446](#) withholding tax liability isn't a partnership item and is therefore beyond the court's authority under section 6226(f).

That provision limits the scope of judicial review in partnership-level proceedings to partnership items and the proper allocation of those items among the partners, as well as the applicability of any penalties or additions to tax.

The Cayman Islands-based partnership, YA Global Investments, claimed in U.S. tax returns that it wasn't engaged in a U.S. trade or business. The IRS disagreed, contending that YA Global was a dealer in securities under [section 475](#) and was thus engaged in a U.S. trade or business.

The IRS determined that all of YA Global's income was ordinary income that was effectively connected with the U.S. trade or business, and that the partnership was therefore required under section 1446 to withhold on U.S. effectively connected income allocable to its foreign partners.

In its petition to the Tax Court challenging the deficiency determinations, YA Global argued that liability under section 1446 is dependent on partner-level determinations and can't be addressed until after a partnership-level proceeding is completed.

The court, however, noted that section 1446 is one of a handful of provisions that explicitly place a withholding burden on partnerships, and that "partnership liabilities" are included within the scope of the definition of partnership items in the relevant Treasury regulations.

"Because [section 1461](#) makes the partnership liable for any tax required to be withheld under section 1446, any tax required to be withheld under section 1446 is a partnership liability," the court explained. "The regulations are clear that partnership liabilities are partnership items."

## Expanded Scope

While most penalties can't be treated as partnership items, the court noted that Congress expanded the scope of partnership-level proceedings under [section 6221](#) to include "any

penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item.”

Moreover, [section 6226](#) explicitly grants courts the authority in partnership-level proceedings to determine penalties relating to an adjustment to partnership items, the Tax Court said.

Therefore, the penalties in the final partnership administrative adjustments were properly before the court, it concluded.

Eric D. Swenson of Procopio, Cory, Hargreaves & Savitch LLP *said the court’s determination that the withholding issue was a partnership item “was the appropriate result and consistent with the regulations that partnership liabilities are partnership items, and the goal of the partnership regime” under the Tax Equity and Fiscal Responsibility Act of 1982.*

“The court is concluding that the withholding issue is more appropriately addressed during the partnership-level proceeding,” Swenson told *Tax Notes*.

*YA Global Investments v. Commissioner*, No. 14546-15 (151 T.C. No. 2) is being argued for YA Global by Henry C. Cheng, Ellis L. Reemer, and Tamara L. Shepard of DLA Piper.